

NAVAL POSTGRADUATE SCHOOL

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THESIS

**A MODEL OF CONTRACT ADMINISTRATION
FOR THE ARMED FORCES OF THE PHILIPPINES (AFP)
MODERNIZATION PROGRAM**

by

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December 1999

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FOR THE ARMED FORCES OF THE PHILIPPINES (AFP) MODERNIZATION
PROGRAM**

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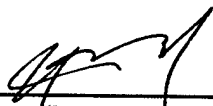
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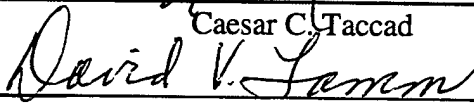
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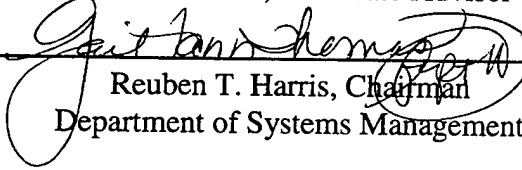
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ABSTRACT

The purpose of this thesis is to determine and develop the appropriate system for the implementation and administration of contracts formulated under the Armed Forces of the Philippines (AFP) Modernization Program. In 1995, the Philippine Congress mandated the modernization of the AFP through a 15-year program under Republic Act (RA) 7898. Subsequently, the Department of National Defense (DND) issued Circular No. 29 to implement the Act. The Circular provided adequate guidance for the conduct of major system contracting, but it did not elaborate on the post-award implementation and administration of AFP contracts. Contract administration is a vital process in government acquisitions; it ensures the successful completion of the contract according to the satisfaction of the parties involved. Without a functioning contract administration system, the AFP risks failure in its Modernization Program. The study identified 12 post-award issues that would affect the successful administration of AFP contracts. Most of the issues are typical of any contracting agency, but some like countertrade, technology transfer, the Bids, Awards and Negotiation Committee (BANC) and the Project Management Teams (PMT), and lack of oversight skills and resources are unique to the AFP context. Using the AFP post-award issues, the prevailing contract administration practices and trends, and other concerns unique to the AFP, the study developed a model of contract administration that incorporates the elements and characteristics essential for its application in the AFP acquisition and contracting environment.

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I. INTRODUCTION

A. BACKGROUND

In 1995, the Philippine Congress passed the Armed Forces of the Philippines (AFP) Modernization Act [10: Sec 19]. The law prescribes the restructuring of the AFP into a more capable military force armed with better weapons and equipment by the year 2010. Subsequently, the Department of National Defense (DND) issued Circular Number 29 on 19 May 1996 as implementing guidelines for the modernization law [12: Sec 51]. Included in the Circular is the process for the procurement of weapons and equipment. It stipulates the procedures for contract formation up to the signing of the contract by the Secretary of National Defense (SND), and its approval for implementation by the President of the Philippines. However, the Circular is silent on the process of contract administration, except for assigning this function to the Major Services under the supervision of the Chief of Staff, AFP. Contract administration is a vital process in government acquisitions; it is as important as the creation of the contract itself. Yet, the Philippine Government provides little guidance on this issue. Apparently, it assumes that the parties involved would infer the process of contract implementation from the terms and conditions of the contract itself.

The administration of Government contracts is barely covered in Philippine laws and regulations; it is not even mentioned in the AFP procurement regulations. Thus, the Major Services will be groping for an appropriate system to address post-award issues, like modifications, contractor default or bankruptcy, dispute resolution, and others, when these issues arise during the implementation of AFP modernization contracts.

B. PURPOSE

The research will determine the appropriate system for the implementation of contracts under the Armed Forces of the Philippines Modernization Program. It will evaluate existing contract administration guidance in the AFP and determine its suitability for the complex contracts that could result from the Modernization Program. It will identify critical post-award problems that are peculiar to the AFP Modernization Program, especially those that routinely arise during contract administration. Then, it will develop a model of contract administration to address these problems.

C. BENEFIT OF THE STUDY

The model to be developed will benefit the Philippine defense establishment particularly the Major Services, who are tasked to implement their respective modernization contracts pursuant to DND Circular No. 29. In the end, the study may even benefit the whole Philippine Government since the model, if successful, could be modified to apply to all Government acquisitions.

D. RESEARCH QUESTIONS

In order to accomplish the purpose of this study, fundamental research questions were developed. The primary research question is: "What are the essential post-award issues associated with the Armed Forces of the Philippine Modernization Program and what would be an appropriate model of Contract Administration to address these issues?"

The subsidiary research questions that lead to answering the primary question are:

1. What is the present structure of contract administration in the AFP?
2. What are the critical post-award problems that routinely arise in contract

administration?

3. How are these problems typically resolved?
4. What are the essential characteristics and elements of a contract administration model for the AFP Modernization Program?
5. What changes in Philippine laws and/or regulations should be considered to incorporate the critical functions and processes of contract administration into the AFP Acquisition Process?

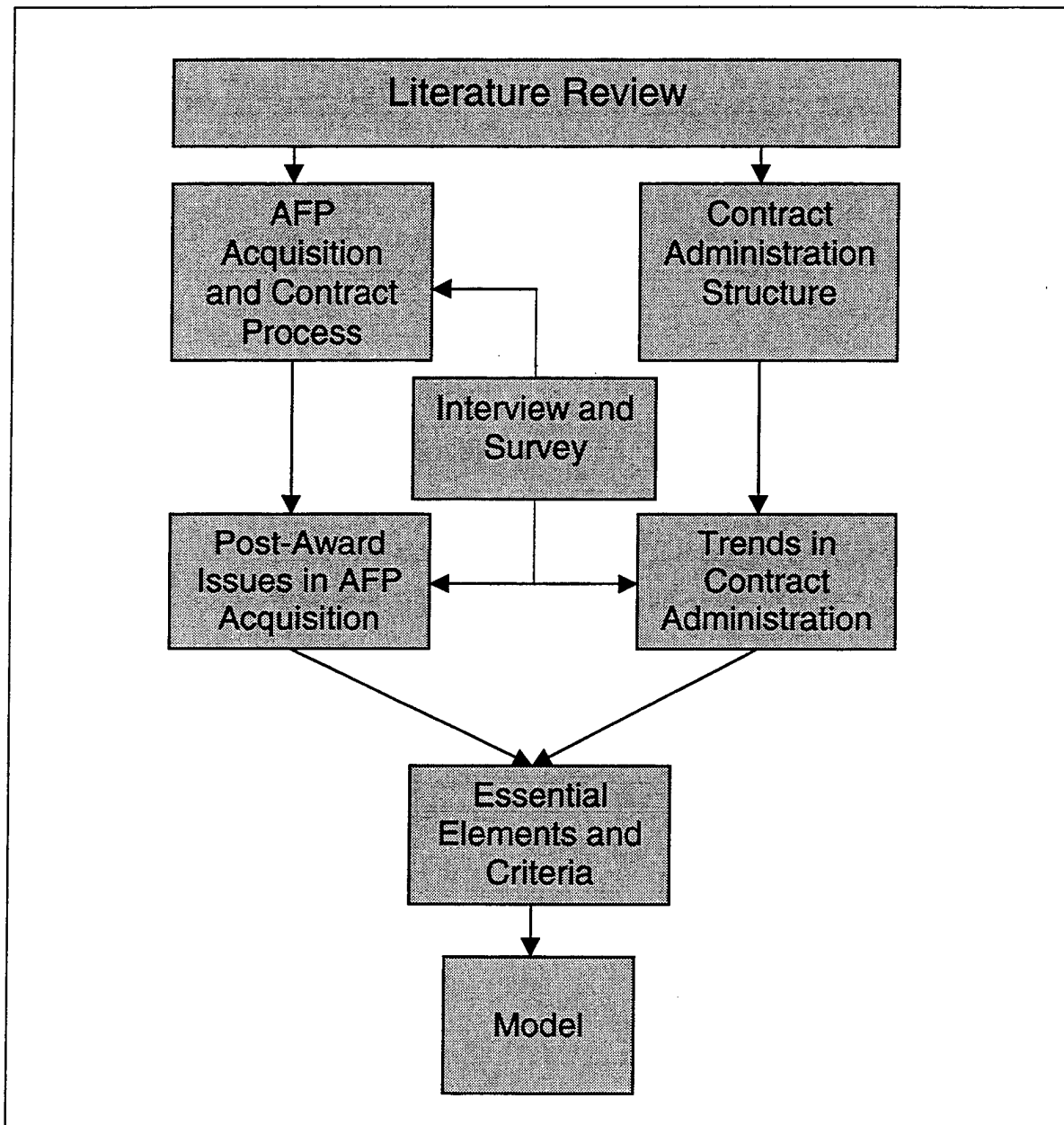
E. SCOPE

The scope of the thesis will be limited to the development of a contract administration model for the AFP Modernization Program. The study will review and evaluate the AFP equipment acquisition and contracting process. It will identify the critical post-award problems and describe the typical system of contract administration that evolved to address these problems. It will identify and assess the possible post-award issues that could arise and be associated with the AFP Modernization Program. It will establish the criteria and identify the critical elements of the contract administration model for the AFP equipment acquisition process. The thesis will conclude with a recommendation for the adoption of the proposed model and provide suggestions for amending Philippine Government laws or regulations to fit the contract administration model into the AFP Modernization Program.

F. METHODOLOGY

The thesis follows a phenomenological research strategy using a theoretical approach. As illustrated in Figure 1, the researcher initially extracted data from previous theses and existing literature on the subject. Then, first hand data were gathered from interviews of key

Figure 1. Research Design



Source: Developed by Researcher.

AFP officials, survey of key AFP practitioners and study of recently concluded contracts of the AFP for system acquisition. The data were then analyzed using both empirical and subjective assessment to determine the most appropriate model of contract administration for the implementation of AFP modernization contracts. Essentially, the research followed the following steps.

1. In-depth review of the acquisition and contracting process for the AFP modernization through examination of AFP modernization law, implementing guidelines, circulars and programs.
2. Review of existing structure of contract administration in the AFP through perusal of Government acquisition laws and regulations.
3. Literature search of books, magazine articles, CD-ROM systems, and other library resources on the subject of contract administration.
4. Establish the general system of contract administration and the prevailing trends in the process through in-depth reading of publications.
5. Determine all the possible critical problems that may routinely arise during contract administration and correlate these in the context of the AFP Modernization Program.
6. Determine the possible post-award issues associated with the contracts under the AFP Modernization Program through interview and survey of officials currently or potentially involved in the Program.
7. Evaluation of the adequacy of the present contract administration structure to address the key post-award issues and problems that were identified.

8. Identification of the characteristics and elements of a contract administration structure suited for the AFP acquisitions under the Modernization Program.

9. Formulation of a model of contract administration using the criteria identified in step eight.

10. Determine necessary changes to Philippine laws and regulations to facilitate implementation of the model of contract administration developed for the AFP Modernization Program.

G. ORGANIZATION

The thesis consists of seven chapters. Chapter I presents the background, purpose, scope and methodology of the research. Chapter II is a discussion on the AFP Modernization Program: the enabling law, the implementing regulations, the defined acquisition process and the inferred contract implementation process. Chapter III contains discussions on the typical contract administration system, the critical post-award problems that contract administration seeks to overcome and the emerging trends on the subject. Essentially, Chapters II and III are outcomes of the literature review. Chapter IV presents post-award issues determined from the study of three recent systems acquisition contracts of the AFP, interview of officials associated with the AFP Modernization Program and survey of persons involved or will be involved in the modernization process. Chapter V is an analysis of the data presented in the three preceding chapters; culminates in a model of contract administration for the AFP Modernization Program. Chapter VI presents the conclusions and recommendations of this study regarding a contract administration model in the AFP equipment acquisition and contracting process, answers the research questions, and suggests areas for further research.

II. AFP EQUIPMENT ACQUISITION AND CONTRACTING

A. INTRODUCTION

This chapter presents the literature review on the Armed Forces of the Philippines (AFP) acquisition and contracting process for the AFP Modernization Program. It contains a review of the pertinent statutes and regulations governing the program, a description and illustration of the acquisition process, and a discussion on how the AFP will implement the modernization contracts. The chapter aims to establish the general context within which the AFP will formulate and implement acquisition contracts.

B. STATUTE AND REGULATIONS

The Armed Forces of the Philippines receives its authority to obtain weapon systems and other equipment from Republic Act Number 7898, otherwise known as the AFP Modernization Act [10: Sec 1]. The statute was signed into law on 23 February 1995. It empowers the AFP to modernize its forces to a level where it can fully and effectively perform its constitutional mandate to defend the sovereignty, and to protect and preserve the patrimony of the Republic of the Philippines [10: Sec 2]. The Law prescribes the size and shape of the Armed Forces, in terms of personnel, equipment and facilities, which the Defense establishment will develop within a fifteen-year modernization period [10: Sec 4].

Critical aspects of RA 7898 are the two sets of parameters included by the Philippine Congress to limit the possible adverse effects of the relatively large military expenditure on the economy. The first set ensures that the modernization program will

not burden the annual budget of the Government to the detriment of other socio-economic projects. The statute requires the Department of National Defense (DND) to sustain the program through the AFP Modernization Trust Fund. This trust fund shall be generated from the following [10: Sec 8]:

1. Congressional appropriations for the AFP modernization program, provided it should not exceed the ceiling of 50 billion pesos for the first five years. Thereafter this amount may be increased commensurate to the increase of the Gross National Product (GNP).

2. AFP shares from the proceeds of the sale of military camps and reservations provided for under RA 7227 (Bases Conversion and Development).

3. AFP proceeds from sale of products of the Government arsenal.

4. AFP proceeds from disposal of obsolescent and unusable equipment of the military.

5. Budget surplus.

6. All interest income of the trust fund.

The second set of parameters ensures that the country will economically and technologically benefit from the AFP acquisitions through reduced foreign exchange outflow, increased local employment opportunities, and enhanced technology transfer to the Philippines. As such, RA 7898 requires the Defense establishment to [10: Sec 10]:

1. Give preference to Filipino contractors and suppliers or foreign contractors and suppliers willing and able to locate a substantial portion of production in the Philippines,

2. Incorporate as far as possible, in each contract/agreement provisions for countertrade, in-country manufacture, co-production schemes or other innovative arrangements, and

3. Include in the contract the transfer to the AFP of principal technology involved for the operation and maintenance of the equipment.

To implement RA 7898, the law requires the AFP to develop and submit a 15-year modernization program, and the DND to promulgate an implementing regulation for the statute [10: Sec 7]. The Modernization Program document, which was approved in Joint Resolution No. 28 by both Houses of Congress in 19 December 1996, outlines the size and shape of the Armed Forces of the Philippines during the various phases of the modernization process [11: Sec 5]. It addresses the capability development of the General Headquarters (GHQ) and the Major Services (Philippine Army, Air Force and Navy) through five component programs. These programs are force restructuring and organizational development, materiel and technology development, base development, human resource development and doctrines development. The Modernization Program includes the modernization projects under it, the priorities, the schedules, and the estimated cost of each project. [3: pp 2-4]

The DND Circular No. 29 *"Implementing Guidelines to RA 7898, An Act Providing for the Modernization of the AFP and for Other Purposes,"* was issued on 19 May 1996 [12: Sec 51]. As the title implies this is the implementing regulation for the AFP Modernization Act. It provides details on the objectives of the statute and defines the policies for the implementation of the five components of the Modernization Program

[12: Sec 2&4-37]. The Circular also directed the Chief of Staff, Armed Forces of the Philippines (CSAFP) to issue implementing instructions to the different services [12: Sec 1].

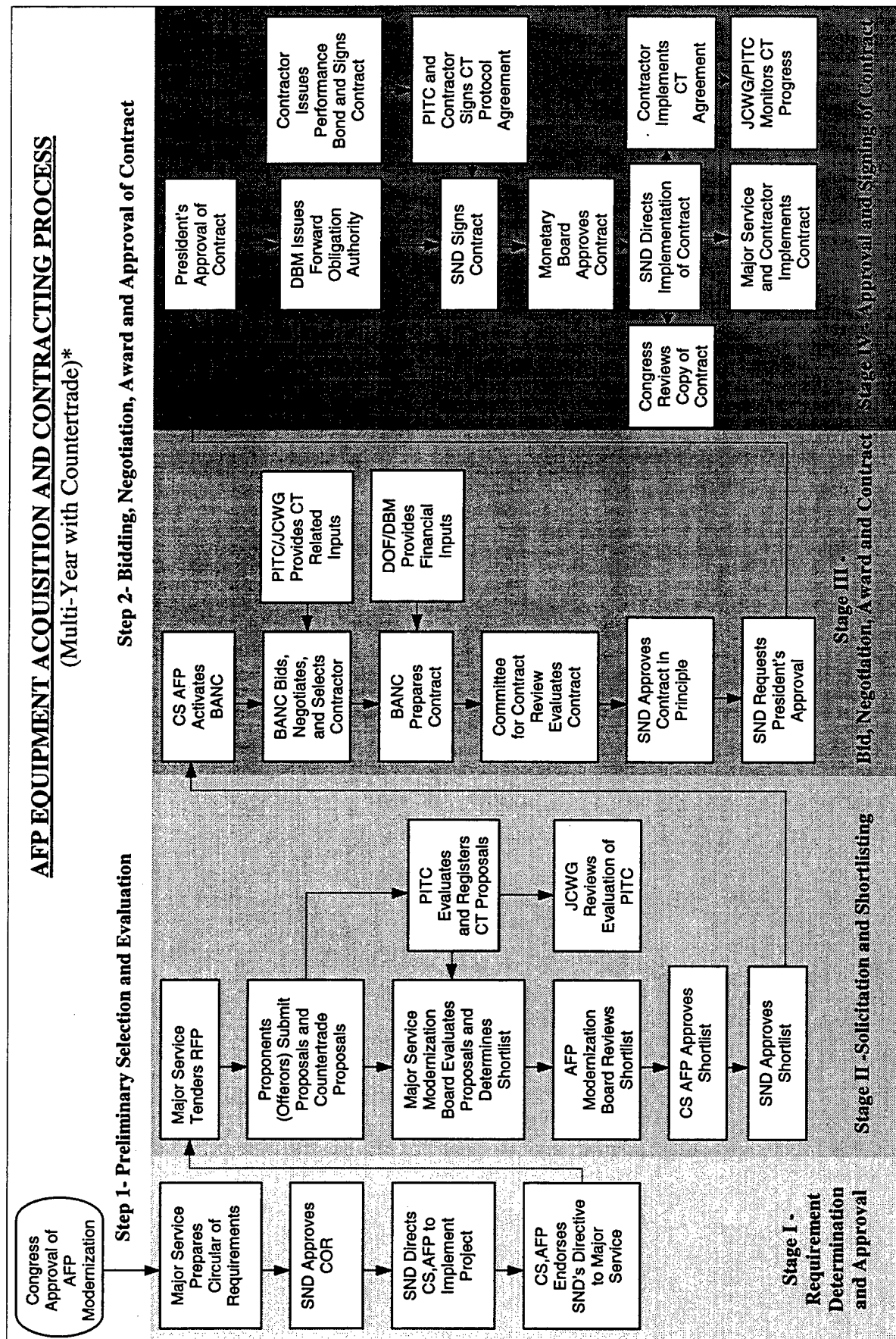
The first of these implementing instructions is AFP Standard Operating Procedure (SOP) No. 2, dated 21 February 1997, "*Bids, Awards and Negotiations Committee (BANC)*." [4: Para 8] SOP No. 2 primarily prescribes the creation of the BANCs – their composition, functions and responsibilities, and establishes guidelines for the activities of the BANCs [4: Para 2]. The BANCs are committees created by the AFP for projects approved by the Secretary of National Defense (SND). Each BANC is assigned one modernization project. It is primarily tasked to select a contractor and prepare the corresponding contract for that project. A BANC is automatically dissolved once the contract for its project is approved [4: Para 5i].

Together, Circular No. 29 and SOP No. 2 provide the process and criteria for the selection of contractors and the approval of contracts [4: Annex B]. This system will be described further in the following section.

C. EQUIPMENT ACQUISITION AND CONTRACTING PROCESS

The AFP equipment acquisition and contracting is a two-step process, graphically illustrated in Figure 2. The two sequential steps are treated separately and each requires separate decisions from the SND [12: Sec 22]. The first step is Preliminary Selection and Evaluation. It involves the determination and approval of requirements, the solicitation and "shortlisting" of offerors, and the authorization of SND for the AFP to undertake bidding or negotiation as the case may be. The second step is Bidding, Negotiation,

Figure 2



Source: Developed by Researcher from DND Cir No.29, 19 May 1996 and AFP SOP No. 2, Feb 21, 1997.

Note: * For single year/without countertrade projects, SND approves and signs contract without passing through the last stage.

Legend: PITC - Philippine International Trade Corporation, JCWG - Joint Countertrade Working Group, CS - Chief of Staff, CT - Countertrade, DOF - Department of Finance and DBM - Department of Budget Management.

Award and Approval of Contract. This step involves the activation of the BANC, the selection through sealed bids of a winning offeror from the "shortlist," the negotiation and award, and preparation and approval of the contract. In Figure 2, the process has been further subdivided for clarity. Step 1 was divided into Stage I (Requirements Determination and Approval) and Stage II (Solicitation and Shortlisting). While, Step 2 was divided into Stage III (Bidding, Negotiation, Award and Contract Preparation) and Stage IV (Approval and Signing of Contract).

1. Stage I – Requirements Determination and Approval

The acquisition and contracting for AFP equipment starts with Stage I upon the approval of the AFP Modernization Program by Congress. In this stage, the Major Services will prepare a Circular of Requirements (COR) for each project under the Modernization Program. The CORs are then submitted individually to SND for approval. Once SND approves the COR, the cognizant Major Service will be directed, through the Chief of Staff, AFP, to implement the project. [12: Sec 22(c) and 4: Annex B]

2. Stage II – Solicitation and Shortlisting

Progressing to Stage II, the cognizant Major Service will now issue a Request for Proposal (RFP) to as many manufacturers of the required weapon system or equipment as possible by direct mail, publication in newspapers (domestic and abroad), or dissemination through Philippine defense attaches and embassies abroad. [12: Sec 22(c)] Interested companies may then submit a Pre-qualification Statement and Proposal with a Letter of Intent and Countertrade (CT) Proposal to the cognizant Major Service.

The Philippine International Trading Corporation (PITC), at this point, will receive the letter of intent and CT proposal for its evaluation and registry. PITC is the Government corporation with whom all foreign suppliers of the Philippine Government are "encouraged," under Executive Order (EO) 120, to negotiate and conclude a countertrade agreement 90 days after the signing of the supply contract [26]. After PITC's action, the Modernization Board of the cognizant Major Service will then pre-qualify the offerors onto a "shortlist," using the companies' pre-qualification proposal and PITC's report. [12: Sec 22(c)] The Board will base its selection on the following criteria [12: Sec 21]:

a. Responsiveness of the proposal to the operational requirements and technical specifications cited in the solicitation. The Board will reject outright proposals that do not meet minimum operational requirements.

b. Total acquisition cost.

c. Life cycle cost.

d. Usage of offered weapon system or equipment by the armed forces of the source country or by the armed forces of at least two countries, pursuant to Sec 4(b) of RA 7898.

e. Corporate and financial profile of the offeror and its track record regarding the item it is offering.

f. Proposed after-sales service and spare parts support.

g. The political stability of countries where the factories of the prime contractor and the sub-contractor are located.

- h. Offer of countertrade and its percentage of contract price.
- i. In-country joint venture, co-production, or similar arrangements to include transfer of technology scheme and identities of possible domestic tie-ups.
- j. In the case of used equipment, the length of time the armed forces of the source country will continue to use such equipment, other countries using it and the number carried in their inventories.
- k. Special relations with or preferential treatment given by source country to the Philippines.

The Board should indicate the preferred equipment and the priority of preference in the "shortlist." It will then submit the list, together with the justifications, for review and evaluation of the AFP Modernization Board. If the AFP Board concurs, CSAFP will endorse the "shortlist" to SND for approval. [12: Sec 22(c)] The approval of SND brings the process into the next stage.

3. Stage III – Bidding, Negotiation, Award and Contract Preparation

Upon receipt of SND directive, the CSAFP shall activate the BANC and cause the preparation of an Invitation to Bid (ITB). The BANC will then convey the ITBs to the offerors included in the approved "shortlist." [12: Sec 22(c)] The BANC will open all bids during a pre-selected time at the AFP Modernization Center, 3rd Floor, Mabini Hall, Camp Aguinaldo, Quezon City, Philippines [4: Para 5h]. Bidding shall be open and transparent to preclude any complaint. The BANC will then evaluate the bids using the criteria consistent with that used by the cognizant Major Service in the "shortlisting," and cost-benefit and cost-effectiveness analysis assigning appropriate weight to the relevant

factors involved. Based on the result of the bidding, CSAFP, upon advice of the BANC, shall recommend to SND the award of the contract to the winning bidder. [4: Para 1e]

The SND shall decide then whether to direct the BANC to negotiate further with the winner or to prepare the contract. In preparing the contract, the BANC will receive additional inputs from PITC for the CT agreements, and the Departments of Finance (DOF) and Budget Management (DBM) for the financial requirements. Once the CSAFP approves the contract, it will then be forwarded to DND for review and evaluation by the Committee for Contract Review (CCR). After concurrence of the CCR, the SND will approve the contract in principle and submit it to the President for approval. [12: Sec 22(c)]

4. Stage IV – Approval and Signing of Contract

The process will enter the last stage when the President receives the contract for his approval. Upon his approval, DBM will then issue Forward Obligation Authority (FOA) for multi-year funding. At about the same time, the contractor will sign the contract and issue a performance bond. PITC and the contractor will then sign the CT Protocol Agreement, an act that signals SND to sign the contract. The contract will then pass to the Monetary Board (MB) for approval. Immediately after Monetary Board approval, SND will direct the cognizant Major Service and the PITC to implement the contract and the CT agreement respectively. SND at this point will also submit a copy of the contract to Congress for review. [4: Annex B]

D. CONTRACT IMPLEMENTATION PROCESS

The AFP equipment acquisition and contracting process, however, does not address the post-award aspect of contract management except for stating that the Major Services will implement their respective contracts. Circular No. 29 mentions briefly some post-award activities, like modification [12: Sec 44] and monitoring [12: Sec 46-49], but these specifically address only program modification and the Project Status Report (PRSR).

Since Republic Act 7898 stated that other applicable laws shall apply in the process of equipment acquisition [10: Sec 14], it could be inferred that the implementation of the contracts would be in accordance with existing laws and regulations. Essentially, the Services will administer the contracts by applying the terms and conditions of the contract in accordance with existing Philippine laws and regulations. So far, these regulations are: (1) the DND Circular No. 29, (2) each Major Service Circular on Project Management, and (3) the Government Accounting and Auditing Procedure of the Commission on Audit (COA). [10: Sec 14]

1. Circular Number 29

As mentioned in the preceding paragraph, DND Circular 29 briefly covered the issue of modification and monitoring. However, modification in this context deals only with the acceleration or deceleration of deliveries or postponement of a project by the AFP because of national emergency. Monitoring in the Circular focuses only on the Major Service preparation and submission of the PRSR to SND. Noteworthy, however, are some data required by the PRSR, which indicates DND areas of emphasis for the

implementation of contracts. These are [12: Sec 48]:

- a. Progress of production and contract performance,
- b. Progress of countertrade or in-country co-production agreement,
- c. Release of funds for down payments and subsequent amortization,
- d. Progress of delivery as against schedule,
- e. Status of payments as against schedule, and
- f. Explanations for project delays.

2. Major Services Circular on Project Management

Another regulation that would apply during post-award contract management is the individual Services' Project Management Manual. An example of this is the Philippine Navy (PN) Circular No. 2 series 1993 [24] and its proposed replacement, the Manual on PN Ship Acquisition Project Management [16]. Although dealing primarily with project management, these regulations contain instructions and procedures that could apply to contract implementation, like production monitoring, quality assessment, cost analysis and risk management.

3. COA Government Accounting and Auditing Procedure

The COA regulation on Government accounting and auditing is another source rules dealing with contract administration. Although the COA Government accounting and auditing procedure provided very little guidance for the execution of supply and services contracts, it gives ample direction for the post-award management of construction contracts. Although not bearing directly on equipment acquisitions, the provisions of the COA regulations could still be applied in principle to the AFP modernization program.

More so, the Regulation has direct relevance for the implementation of the base development component of the modernization program, which would normally include construction projects.

The applicable provisions in the COA regulations are in the areas of Commencement of Contract Performance, Government-Furnished Property, Contract Variations, Payment and Financial Support, and Suspension, Liquidated Damages and Terminations.

a. Commencement of Contract Performance

The Government will issue a Notice to Proceed (NTP) to the successful bidder within fifteen calendar days after the approval of contract [9: Sec 566]. In the event that the NTP was issued after 120 calendar days from the date of bidding, the contractor is entitled to request for a contract unit price adjustment using prescribed parametric formulae updated to the month of the NTP. Another requirement during contract start is the posting of a Performance Bond by the winning bidder [9: Sec 256(k)-256(q)]. The performance security shall be 5% of the total contract price if it is in cash, manager's or cashier's check, irrevocable letter of credit, or bank draft, ten percent if it is in the form of a bank guarantee, or thirty percent if it is a surety bond. Subject to the conditions of the contract, the performance security may be released by the procuring agency after completion of the project provided no claims were filed against the contractor.

b. Government-Furnished Property

The Government can furnish materials and equipment to contractors when stipulated in the contract. In such cases, a Property Accountable Officer shall issue the

equipment to the contractor duly covered by a Memorandum Receipt for Equipment (MR). In the process, the contractor shall be liable under Sections 493 and 495-500 of the COA regulation for the care, maintenance, repair, loss and return of the property. Disposal of the property by the contractor is not allowed. Only the Government has full and sole authority and responsibility for the divestment or disposal of its assets.

c. Contract Variations

The Government could modify the contract through Change Orders, Extra Work Orders or Supplemental Agreements [9: Sec 568]. A change order may be issued when there is an increase or decrease in work due to addition or deletion of work items, reclassification of an existing item, or damage or destruction of finished work due to force majeure. Change orders are limited to changes costing not more than 25% of the original contract cost. Otherwise, the changes can only be effected through a supplemental agreement. Extra Work Orders on the other hand are those issued by the Government for additional work needed and necessary to complete, improve or protect the project because of unknown or latent conditions of the work site. As an absolute rule, change orders or extra work orders should only be issued for addition/deletion of jobs necessary for the completion and within the general scope of the project. If the change is beyond scope or costs more than 25% of the original contract price, a supplemental agreement should be used instead of a change or extra work order. [9: Sec 568]

In any contract variation, the Government reimburses the contractor the actual cost of change, as determined by the latter's direct labor cost, all materials used for the

extra work, all incidentals like fuel, supplies, etc, and current rental rates of equipment if applicable. [9: Sec 569]

d. Payment and Financial Support

The Government pays the contractor only after receipt and acceptance of the contracted item or work [9: Sec 571]. There are, however, cases where the contractor receives advance payment immediately after the NTP. The Government makes the advance payment upon written request of the contractor provided it is not more than 15 percent of the total contract price. To effect payment, the contractor must submit an irrevocable letter of credit of equivalent amount from a commercial bank or a guarantee bond from a surety. [9: Sec 571]

Aside from advance payments, the contractor may request progress payments once a month or for accomplishment of work worth at least One Million Pesos (PHP 1 million). However, the Government will not approve such payment unless the cognizant project officer confirms and certifies that work is progressing satisfactorily in the interest of the Government [9: Sec 572]. In addition, the Government retains ten percent of every progress payments as "retention money" until 50 percent of the work is satisfactorily completed and on schedule [9: Sec 573]. The total "retention money" will only be released to the contractor upon acceptance of the final item or work.

e. Suspensions and Terminations

The Government or its agents have the authority to suspend work, wholly or partly, for a period deemed necessary due to force majeure or fortuitous events, or failure of the contractor to perform any provisions of the contract, or due to possible changes

found necessary for contract performance [9: Sec 574]. After suspension, the contractor, if not at fault for the work stoppage, is allowed adjustment of contract deadline equivalent to the length of the suspension. However, in case of a suspension or delay caused by the contractor that exceeds a time duration equivalent to 20 percent of the specified time, the cognizant agency may terminate the contract, forfeit the performance bond and re-award the project to another qualified contractor through negotiations. [9: Sec 574]

There is practically no guidance or rule on how the AFP would execute modernization contracts. The few published rules do not deal with the process directly, and the most extensive of these deal more with construction contracts for the Department of Public Works and Highways (DPWH). At any rate, the AFP could derive and apply relevant guidance from the above-cited regulations particularly in the areas of contract start ups, monitoring and quality assurance, government furnished property, contract modifications, payments and financing, work suspensions and termination for default.

E. SUMMARY

This chapter described the AFP equipment acquisition and contracting process in DND Circular No. 29. The process is a two-step system, which the researcher divided further into four stages: Requirement Determination and Approval Stage, Solicitation and Shortlisting Stage, Bids, Negotiation, Award and Contracting Stage and Approval and Contract Signing Stage. The process is limited to contract formation and essentially ends after contract award. This shortcoming forced the AFP to rely on three different acquisition regulations for contract administration, but none of which is definite and comprehensive enough for system acquisitions under the AFP Modernization Program.

The chapter showed the existing contract administration context for the AFP Modernization Program. It described how the AFP could presently implement contract start-ups, monitoring and quality assurance, government furnished property, contract modifications, payments and financing, work suspensions and termination for default.

The next chapter will describe the general contract administration system. It is a literature review on contemporary contract administration and provides a broad understanding on the subject.

III. POST-AWARD ADMINISTRATION OF GOVERNMENT CONTRACTS

A. INTRODUCTION

This chapter presents the result of the literature review on Contract Administration particularly in a government context. It identifies the post-award problems, defines contract administration, describes the general contract administration system, and discusses some contract administration trends. The objective of this chapter is to provide a broad understanding on the subject and its importance for the fruitful completion of a contract.

B. POST-AWARD PROBLEMS

Contract management does not end with the approval and signing of the contract by both parties. In fact, as long as agreements or actions stipulated in the contract are not yet complete, interaction continues and its intensity may even increase. Proposals and counter-proposals may be exchanged and negotiations made between parties until the last item is delivered and payment made. Naturally, problems may come up during the transactions and these have to be resolved to complete the contract satisfactorily. Below are critical post-award problems identified from acquisition cases given in the book of John W. Whelan, *Federal Government Contracts*, that could routinely arise during contract performance:

1. Non-Compliance to Contract Specification

Non-compliance of contractors to the specification of the contract is a crucial problem since it leads to contract failure. Examples of this kind of problem are the Laka

Tools and Stamping Company (1980), the National Presto (1964), and the Spearin (1918) cases [37: pp 327-354]. Although these landmark cases led to different rulings on the subject of specifications, the mere fact that they exist is clear evidence that problems of compliance to specifications could happen.

2. Disagreement on Contract Modifications and Equitable Adjustments

Sometimes the terms and conditions of the contract itself, due to mistakes, changes in technology, increase in material cost, or other causes, hinders contract performance. In these instances, changes to the contract may have to be made. It is during the modification process that often misunderstanding occurs between the contracting parties. The General Dynamics Corporation (1978) [37: pp 357-367] and the KECO Industries Incorporated (1966) [37: pp 392-401] cases are clear evidence of changes and modification problems.

3. Disagreement in the Result of Inspection and Warranty of Deliverables

Problems with the contract could still arise even after production because of conflicting claims regarding inspections and warranties. This predicament is usually characterized by the exchange of accusations regarding who is at fault for the deficiencies in the product and therefore should be penalized for the deficiency. The Instruments for Industry Incorporated (1974), Kaminer Construction Corporation (1973) and John C Kohler Company (1974) cases are examples of this type of problem [37: pp 415-435].

4. Settlement of Claims

Most disagreements lead to a contractor or the government filing a formal claim. This could result in a dispute and eventually to a costly litigation that drains the resources

of both parties and jeopardizes the successful completion of the contract. An example of this is the Martin J Simko Construction Incorporated (1988) case [38: p 118].

5. Contractor Financial Difficulty and Bankruptcy

Sometimes, a contractor may develop acute cash-flow problems because of the large disbursements required for some government projects. To alleviate this situation, the government may resort to financial assistance plans for contractors. The government may do this to minimize the risk of contractor default or bankruptcy. The Kimbell Foods Incorporated (1979) [37: pp 105-115] and the Marine Midland Bank (1982) [37: pp 442-453] cases are classic evidence of the government getting caught in the financial difficulties of its contractors.

6. Issues with Government-Furnished Property

This problem ranges from issuance of government property to management, accounting, and disposal of the property. Untimely delivery of government-furnished property normally leads to government liability pursuant to the terms of the contract. In addition, mismanagement by the contractor could lead to loss, damage or destruction of the property. Thus, it is reasonable for the government to place some importance on this issue. The Teledyne Lewisburg (1983) case is one of the many experiences of the government on this matter [37: pp 469-480].

7. Subcontractors and Privity of Contract

Since a contract is an exclusive agreement between parties, the government cannot deal directly with the subcontractors. The government, because of privity of contract, has to deal only with the prime contractor, even on matters that only concerns the

subcontractor. This setup could easily lead to miscue and misunderstanding that in some cases results in grave problems in contract performance. The landmark Merritt (1925), Severin (1943) and Folk Construction Company (1983) cases are some of the examples of this kind of problem [37: pp 285-313].

8. Importance of Contractor Production for National Defense

Sometimes a financially troubled contractor or a contractor in a disadvantaged contractual position may be required to continue production for national defense despite of its unfavorable business position. In these cases, the government may have to provide or allow deviations, waivers, modifications, or assistance to allow continuation of production despite the fact that some provisions of law may prohibit it. If the situation is not remedied, the contractor could lose the ability or the capacity to produce the needed item thereby placing the defense of a nation in jeopardy. [14: pp 301-303]

Each problem presented above may have a critical impact on a contract performance. The cases cited were individually resolved through litigation, which led to rulings that were later incorporated, either by operation of law or through legislation, into the body of procedures and regulations that make up the U.S. Government Contract Administration System. The outcome however should not be limited to the U.S. context, because other countries are also aware of such problems. The Philippines, for example, has terms and conditions incorporated in its contracts that indicates knowledge in the effects of above-cited problems to contract performance. [20, 21 & 22] As such it could be argued that all countries essentially have a similar contract administration structure, which in general, does not only provide a process for resolving post-award problems but

also presents an organized and systematic process for preventing such problems from occurring.

C. CONTRACT ADMINISTRATION

Implementation of contracts would require a management system conventionally known as Contract Administration. According to Stanley N. Sherman in his book, *Contract Management: Post-Award*, contract administration applies to a broad spectrum of undertakings from large sophisticated constructions to manufacture of all kinds of lesser products[28: p 6]. It applies to production, research and development, most service contracts, and nearly all purchases that call for performance effort to begin after award of contract. It concerns both the buyers' objectives and the suppliers' interests. It provides a practical way for top management to establish a definable level of control over the operations it sponsors but assigns to an external source to be fulfilled. Dr Sherman defines contract administration, or post-award contract management as he calls it, as

...the set of techniques, policies, and practices through which parties to a contract seek to ensure that specific work that has been assigned for performance by one party is progressing and will be accomplished in accordance with the established agreement between the involved organizations [28: p 7].

The goal of contract administration is to ensure that performance meets the objectives, which are definable in terms of three categories of measurement: performance, schedule, and cost. [28: pp 6-7]

Contract administration comprises a variety of functions. In fact, the U.S. Federal Acquisition Regulation (FAR) cites 80 such functions [35: 42.3], which Dr. Sherman grouped into six broad categories [28: pp 142-143]:

1. Monitoring and surveillance – These functions secure information concerning the contractor's compliance with contract provisions.

2. Reports and services to procuring office and contractor – These functions, which are characterized by analyses, evaluations, recommendations, preparation or delivery of services or documents, benefit the procuring activity or the contractor.

3. Reviews and audits of contractor internal management systems – These functions involve reviews of the contractor's systems that will affect the cost, schedule and performance of the contract.

4. Formal decisions and actions affecting contractors – These functions involve decisions that alter or correct the course of contract operations or the contractual relationship itself.

5. Directions, negotiations, and agreements – These functions require negotiating skills to resolve controversy, redirect work, make cost and price adjustments, and settle claims to bring the contract to a successful or at least acceptable conclusion.

6. Program sensitive contract management functions – These functions are those affecting the agreement on price, schedule, or performance, like change orders, negotiation of price increases or termination or default actions.

Keith M. Moore in his thesis, *Contract Administration Organization: A Case Study of the U.S. Marine Corps Advanced Amphibious Assault Vehicle Program*, arranges 73 contract administration functions according to the six broad categories, which is presented in Table I [18: pp 36-37]. According to Moore, the Program Management Offices (PMO), the Procuring Contracting Officers (PCO) and the Contract

Administration Offices (CAO) are the ones who generally fulfill these tasks and responsibilities. Some of these overlap; others are exclusive to a particular office. Many of the functions have a lead agency with other offices supporting in some of the activities required to discharge the responsibility. Other tasks have joint responsibilities, with no clear lead agency, and have multiple participants [18: p 26].

Table I. Categories of Contract Administration Tasks

<p><u>Monitoring and Surveillance</u></p> <ul style="list-style-type: none"> • Post-award conference • Ensure appropriate restrictive markings • Administer security requirements • Monitor contractor industrial relations • Monitor compliance with contract provisions • Ensure notification IAW limitations of cost clause • Monitor production status/progress • Identify design and development deficiencies • Conduct inspection of end items • Observe contractor tests of items <p><u>Reports and Services to PM and Contractor</u></p> <ul style="list-style-type: none"> • Oversee timely submission of CDRL • Provide technical & administrative review VECP's • Assist contractor in obtaining appropriate tax exemption • Issue duty free certificates • Assist priorities and allocations • Administer advance payment & maintain special bank accounts • Review contractor proposals • Gather pricing data for negotiations • Conduct engineering review of contractor proposals • Observe and report deficiencies in specs or technical documentation • Evaluate contractor engineering, design, ECP's, etc • Evaluate contractor requests for deviation and waivers • Submit progress reports on activity & potential delays <p><u>Review and Audit of Contractor Internal Management Systems</u></p> <ul style="list-style-type: none"> • Review contractor maintenance, logistics and safety prog • Conduct audit of contractor budgeting, scheduling, and accounting systems • Verify financial condition of contractor and contract • Verify work progress for payment of contractor • Review request for advance payment • Review and audit of contractor insurance practice • Review statements on status of progress payments • Review contractors revised cost estimates at completion • Review contractor's data mgmt & production system • Assess contractors value engineering program • Review contractors practice for preservation and packing • Review contractor's property accounting system 	<p><u>Formal Decisions and Actions Affecting Contractors</u></p> <ul style="list-style-type: none"> • Review and approve contractor subcontracts • Release shipments from contractor • Determine final overhead rates • Issue notice to disallow cost • Determine adequacy of contractor CAS disclosure statement • Verify contractor compliance to disclosure statement • Screen, redistribute and dispose residual property • Process requests for government property • Authorize non-contractual use of government property & receive rent <p><u>Directions, Negotiations and Agreements</u></p> <ul style="list-style-type: none"> • Make administrative changes to contract • Negotiate forward pricing rate agreements • Negotiate interim billing rates • Negotiate contract price adjustments • Negotiate final pricing of incentives • Negotiate advance agreements • Execute supplemental agreements • Negotiate settlements of terminations • Negotiate handling and mymnt. excess GP by contractor • Negotiate adjustments of shipping instructions <p><u>Program Sensitive contract administration Functions</u></p> <ul style="list-style-type: none"> • Oversee timely submission of CDRL • Review cost performance reports • Ensure compliance with contract provisions • Ensure notification IAW limitations of cost clause • Review proposals • Process and evaluate changes • Monitor production status/progress • Identify design and development deficiencies • Conduct engineering reviews of contractor proposals • Evaluate & approve contractor eng'g and design studies • Evaluate & approve contractor request for deviations and waiver • Review contractors revised estimates of cost at completion, work plans, etc • Review contractor data mgmt & production system • Inspect and test end items • Process request for government property • Review & approve purchase or fabrication of test equipment
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Source: Moore, K. M., 1996, pp 36-37

D. THE CONTRACT ADMINISTRATION STRUCTURE

The general contract administration system is complex and many of its functions are intertwined among the various sub-processes and agencies. An outcome, like a report or a payment, may require two or more agencies to perform several tasks simultaneously and sequentially to complete. It could require work that would include functions from all the six categories.

Figure 3 presents a simplified model of contract administration. The system is divided into three groups of processes: Contract Performance, Contract Administration Support, and Contract Deviation, Termination and Problem Resolution.

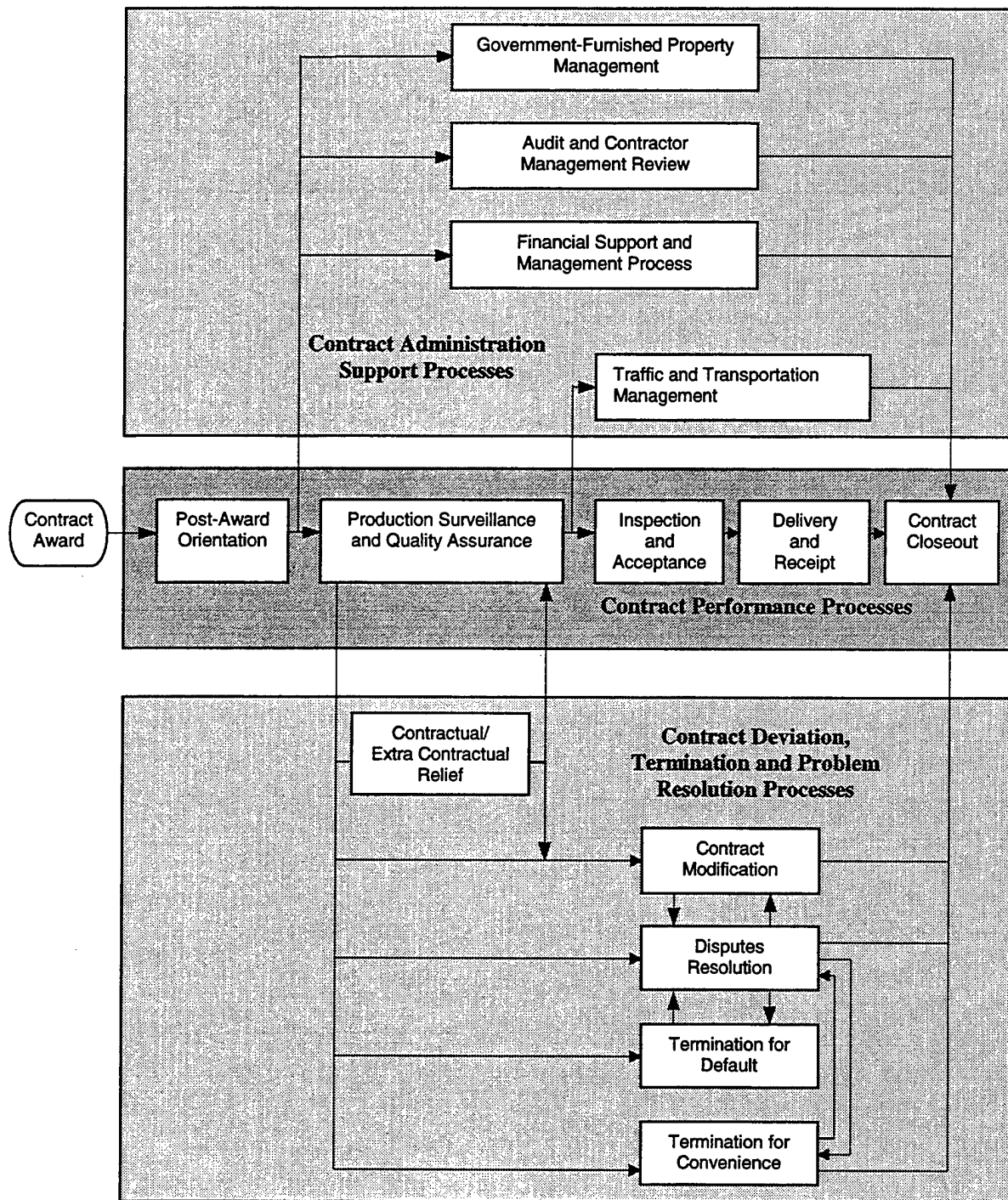
1. Contract Performance Processes

This group is comprised of core functions performed by the contract administration office with the contractor. It is shown in the middle portion of Figure 3. It starts immediately after contract award and ends with contract closeout. It ensures the delivery of the services or products contracted according to specified quality, cost and schedule. This group includes Post-Award Orientation, Production Surveillance and Quality Assurance (QA), Inspection and Acceptance, Delivery and Receipt, and Contract Closeout. These processes are generally performed sequentially from contract award to contract closeout.

a. Post-Award Orientation Process

Generally, the orientation process is the first step after the award of the contract where the government redirects its efforts and resources from pre-award to post-award activities [35: 42.5]. This involves the orientation of the contractor and the

Figure 3. Government Contract Administration



Source: Developed by the Researcher from U.S. FAR and various publications on contract administration.

delegation of responsibilities to those concerned for satisfying the obligations of the government under the contract. The process starts with contract administration planning by the government with the contractor. The plan establishes the appropriate level of surveillance or monitoring of contractor performance, and delineates the timely and proper performance of the government's responsibilities. It could be formal or informal, but a formal plan is essential when the contract involves large monetary value or complex technical requirements. [35: 42.5]

Another aspect of the process is the orientation of the contractor. This may take the form of a telephone call or a letter, but a Post-Award Orientation Conference is normally held for complex contracts. The purpose of the orientation conference is to ensure that both parties have a clear and mutual understanding of all contract requirements, identify and resolve potential problems except modification of the contract, and set the stage for a good working relationship under the contract. Often, the persons who perform or administer the work did not participate in the events leading to contract award. The orientation conference can help them understand the terms and conditions of the contract. [35: 42.5]

b. Production Surveillance and Quality Assurance

Following the orientation process is the monitoring or surveillance of the contractor performance [35: 42.11]. This process ordinarily involves the monitoring of production status and progress. It ensures that the products or services meet the required specification or quality. The production is progressing smoothly towards timely delivery and within reasonable cost. In addition, the process verifies whether the contractor

complies with the other terms and conditions of the contract like clauses on labor rates, subcontracting goals, maintaining drug-free workplace, etc. Some of the activities under this process are: identify design and development deficiencies, observe and report deficiencies in specifications or technical documentation, and submit progress reports on activity, or potential or actual delay. Production surveillance or monitoring should be consistent with the monetary value, type and complexity of the contract. Under a fixed-price supply contract, the monitoring is waived and the end user may inspect and accept the deliverables for the government. Under a production contract, a quality assurance specialist may monitor, inspect and accept the work. In major systems contracting, a team or an entire contract administration organization could be involved in monitoring, inspection, and acceptance. [35: 42.11 & 46.4]

c. Inspection and Acceptance Process

This process is the logical continuation of monitoring and surveillance. It involves the inspection and test of products and services to ensure these conforms to the contract specifications. The function could be performed at the contractor's plant or at the customer's premises. [35: 46.5]

d. Delivery and Receipt

The end user receives the contracted item during this process. The contractor submits invoices, for approval by the Contracting Officer (CO) or his representative, based on the contract price for worked delivered and accepted, costs incurred, or progress made under the contract. The reason for the approval is to protect the interest of the government by ensuring that payment is commensurate to work performed. At times, the

CO may not authorize payment in full to avoid paying unallowable costs, to reflect adjustments resulting from contract modification, or for some other reasons. [34: pp 8-27 to 8-28]

e. Contract Closeout Process

The purpose of this process is to ensure that the contract is administratively completed, wherein both parties have met all contractual obligations and the interest of the government is protected [36: pp 7-21]. The process involves the verification that the contract is physically complete; obtaining contractor's final invoice, contractor's closing statement, and other reports, forms and clearances; verification that both parties have satisfied other terms and conditions for closeout; settlement of outstanding issues; verification that there are no outstanding claims or disputes; and final payment and de-obligation of remaining funds.

2. Contract Administration Support Processes

This group is the support activities performed by the contract administration organization and other agencies. It is comprised of functions performed simultaneously when needed with the activities in the Contract Performance Processes to ensure continuous and unhampered performance of the contract. Processes in this group are Management of Government-Furnished Equipment, Audit and Contractor Management Review, Financial Support and Management, and Traffic and Transportation Management (Figure 3). Some of these functions are performed by the contract administration organization itself but most are generally performed by other agencies like

Finance, Audit, Transportation Support and Property Support organizations, in support of the former.

a. Government-Furnished Property (GFP) Management

This process involves the management of government property furnished to the contractor, and government entitled property acquired or manufactured by the contractor under the contract [35: 45.3]. When the government furnishes property, the contractor is responsible for inventory, maintenance and protection of the property. He must also ensure that the property is only used for purposes of the contract. Therefore, the government must have property specialists and the procedures to confirm that the contractor has adequate property management system, to monitor the contractor's management of the property, and to oversee recovery and disposal of the property. [35: 45.3] Some of the functions under this process are: review of contractor's property accounting system, processing of request for government property, and screening, redistribution and disposal of residual property [18: pp 36-37].

b. Audit and Review of Contractor Management Process

This process involves the review and audit of the cost accounting and internal management systems of contractors [28: pp 154-156]. The work performed could be characterized as consultation or inspection depending on the goal or situation. The process requires a high degree of expertise in accounting and management systems. The systems reviewed are usually those that have impact on government costs, timely delivery and adequacy of contractor performance. The process, therefore, is the government's way of verifying that the contractor uses efficient and effective systems for managing

government projects. [28: pp 154-156] Some activities under this process are: audit of contractor budgeting, scheduling and accounting systems, review of contractor purchasing system, review contractor maintenance, logistics and safety programs, monitoring of contractor industrial relation, verification of financial condition contractors and contracts, and assessment of value engineering program of contractors [18: pp 36-37].

c. Financial Management and Support Process

This process ensures that the government promptly pays the contractor for his deliveries or services [34: pp 8-26 to 8-33]. Normally, the finance office makes the payment after the CO approved the invoices. The approval process is relatively straightforward for fixed-price contracts. For cost-reimbursement contracts, however, approval is dependent on a determination of the allowability of the invoiced costs (direct and indirect costs). [35: 42.7&42.8]

Another aspect of this process is the granting of government financing or loan guarantees to the contractor [28: pp 289-291]. One such financial method allows contractors to use its "right to be paid" by the government for contract performance, ongoing or still to be performed, as a security for a bank loan. Under an assignment of claim, the lending institution makes a loan to a contractor. The government then makes contract payments directly to the lending institution. Another financing method is through progress payments. Under this method, the contractor is not paid for items or services delivered but for cost incurred within pre-determined periods. Here, the contractor collects from the government at regular intervals based on the incurred cost

during the specified period and not on the services or product made so far. [5: pp 15-8 to 15-18]

On the opposite end of this financial service is the collection of contractor debts. A contractor may owe the government money for overpayment, government expenses for correcting latent defects, damages or other reasons. The government generally collects debt through "offsets" against the contractor's next invoice, cash payments from contractors, or applying tax credits due to a contractor against the debt. [5: pp 15-19 to 15-20]

Other activities in the financial management and support process are review of contractors revised estimates for cost at completion, work plans, etc; issuance of notice of disallowance; determination of final overhead rates; negotiation of interim billing rates and forward pricing rates; final pricing of incentives; review of cost performance reports and conduct of actions to protect the government financial interest in cases of contractor bankruptcy. [18: pp 36-37]

d. Traffic and Transportation Management

This process ensures the safe and prompt shipment of contracted product. It includes the issuance of duty free certificates, review of contractor practices for preservation, packaging and packing, and release of shipment from the contractor. [35: 42.14, 47.1 & 47.2]

3. Contract Deviation, Termination and Problem Resolution Processes

This last group is comprised of corrective activities performed by Contract Administration Organization and the Procuring Agency, if separate, to bring a sidetracked

contract back on its tracks, or steer another to a new path or approach. This group also includes processes that, if called for, could end a contract before completion of contract performance primarily to protect the interest of the Government. The group involves Contractual/Extra Contractual Relief Process, Contract Modification, Dispute Resolution, and Contract Termination Process (Figure 3). Remedial processes are activities that steer failing contracts back on track or those that introduce slight changes to contracts. On the other hand, termination processes are activities that abort a contract before its completion because of contractor breach, or when an event or development renders the contracted item useless or obsolete. Generally, terminations are made to protect the interest of the government.

a. Contractual/Extra Contractual Relief Process

The contractual/extra contractual relief process involves functions performed during the performance period to correct performance problems like delays or those leading to "stop work" situations [35: 42.13]. Delays are situations that threaten the timely completion of the contract due to the contractor's or the government's negligence or fault, or factors beyond control of either. "Stop work" occurs when the CO concludes that it is in the best interest of the government to stop contractor's work because of the possibility of terminating the contract, Government property can not be furnished per contract schedule, calibration of production line tools, possibility of substantially changing the production method, or considerations are being contemplated to modify the contract. Ordinarily, delays are resolved through schedule extensions if the delay is excusable or through equitable adjustments if the government is at fault. "Stop work"

notices are temporary, stoppages of contract performance that end automatically after the mandated grace period unless extended through supplemental agreements or work permanently stopped by contract termination. Other remedies within this process are the assessment of liquidated damages, rejection of non-conformal work, exercise of applicable warranty or guarantee, and issuance of "cure" or "show cause" notices. [34: pp 8-18 to 8-20]

On the other hand, the extra contractual relief process includes activities that invoke the unusual powers of the President in connection with national defense [35: 50.1]. When authorized by the President, the agencies may enter into contract amendments or modifications and make advance payments without regard to other provisions of law relating to the making, performance or modification of contracts. The primary purpose of the process is to maintain the contractor's production ability, when is deemed essential to the national defense. Actions made during this process may include contract modification without consideration to the government, correction of mutual mistakes in the contract and formalization of informal agreement. [14: pp 301-303]

b. Contract Modification Process

The contract modification process involves activities that lead to written changes in the terms and/or conditions of the contract provided these are not cardinal changes [34: p 8-10]. It is initiated either by change proposals from contractors or change orders from the CO. Either way, changes lead to equitable adjustments in the contract price, delivery schedule or other elements of the contract. In some cases, a CO may unilaterally modify a contract, especially if this only constitutes an administrative change

that does not affect the substance or price of the contract. Unilateral substantive changes by the CO are also allowed, but these risk disagreement with the contractor. Should the latter disagree, a claim may be filed and could lead to costly dispute between the government and the contractor on equitable adjustment issues [34: p 8-10]. A better alternative for substantive changes would be through bilateral modification of the contract using a supplemental agreement to be negotiated and signed by both the CO and the contractor. Some of the activities made during this process are evaluation of contractor engineering change proposals, requests for deviation, negotiation on contract price adjustments, and review of contractor revised estimates of cost at completion, work plans, etc. [35: 43.1&43.2]

c. Disputes Resolution Process

The contracting parties resort to this process when there is material disagreement between the government and the contractor, which may result in a claim or is all or part of an existing claim [35: 33.2]. A claim is a written demand or assertion by one of the contracting parties seeking, as a matter of right the payment of money in a certain sum, the adjustment or interpretation of a contract terms, or other relief arising under or relating to the contract. [5: pp 19-4] Policy preference is for all material disagreements and claims to be resolved by mutual agreement at the contracting officer's level. If not achievable, the CO must render a final decision, which the contractor could appeal within a prescribed period before a higher authority or a board of contract appeals. The board will then render its own decision, which could then be appealed by the losing party to cognizant judicial courts within a prescribed period. From there, depending on

the merits of the case, the appeal could be elevated up to the highest judicial body or court. [5: pp 18-1 to 18-9]

As an alternative to litigation, the contracting officer may resort to Alternative Dispute Resolution (ADR) before, after or instead of rendering a final decision. However, the use of ADR if made after the issuance of the final decision does not alter any of the time limitation or procedural requirements for filing an appeal. [5: p 18-11]

The dispute resolution process when completed could lead to settlements requiring continued performance of the contract without changes or with modifications and equitable adjustments. The dispute resolution process could also lead to termination of the contract either for default or for convenience of the government depending on the situation.

d. Termination Process

The government reserves the right to terminate contract performance either because the government's requirement has substantially changed or has been cancelled or the contractor fails, or is failing, to perform as required by the contract [35: 49.1]. When the government requirement changes, the contract may be partially or wholly terminated for convenience. In this case, the CO issues a unilateral notice terminating the contract for the convenience of the government. This action is usually followed by a supplemental agreement reflecting the resulting change in price, disposition of property, and other matters affected by the termination. [35: 49.2 & 49.3]

In instances when the contractor is failing to perform in accordance with the terms and condition of the contract, the contracting officer may exercise the right to

terminate the work, in whole or in part, for contractor default [34: pp 8-48 to 8-49]. When sufficient evidence exists to suspect that the delivery or other performance requirements are not likely to be met, the CO may issue a "cure notice" to warn the contractor to perform better and deliver requirements within schedule. If the contractor fails to heed the "cure notice," then termination for default may proceed forthwith. On the other hand, when the delivery due date elapsed before the contractor could comply. The CO may either issue a "show cause" letter to the contractor to allow him to explain his failure, or immediately initiate default termination. Once the contract is terminated, the contracting officer may secure services from another source and bill the terminated contractor for the excess cost of reprocurement. [35: 49.4]

E. TRENDS IN CONTRACT ADMINISTRATION

The passage of the Federal Acquisition and Streamlining Act (FASA) in 1994 and the Federal Acquisition Reform Act (FARA) in 1995 began a sweeping reform process throughout the U.S. Federal Acquisition System [29 & 30]. Driven by U.S. Government budget reduction, innovative methods were sought to reduce acquisition costs and the need for extensive acquisition resources. In Contract Administration, the reforms signaled a trend towards less Government oversight of contractor performance. The present thrust is to provide more insight rather than oversight in managing the contract. The budget now is inadequate to maintain the desired level of resources for oversight of contractor performance. The Government has to rely more on the internal management system of the contractor and his inherent business and economic motivation to provide quality services or products at the most competitive prices to his customers. [18: p 64]

Another trend is the move towards the establishment of teaming arrangement with contractors. The Government and the contractor must resolve issues and problems together, in a cooperative way from contract award to closeout. The use of Integrated Product Teams (IPT), which are formed during the contract formulation phase with the contractors, would be extended into the contract administration phase preferably until contract completion [32: p 2 & 33: pp 5.2-5.4]. The main advantage of this arrangement is that continuous communication can be maintained between the parties making it easier to coordinate activities and avoid disputes. The Government will also be able to take advantage of expertise in the contractor organization, including those it lost due to downsizing.

F. SUMMARY

This literature review showed that contract administration evolved, by operation of law and by legislation, to deal with critical post-award problems that may arise during contract performance. The primary purpose of Contract Administration is to protect the interests of the government during contract performance; it ensures that the contractor delivers the product in the right quality, at reasonable cost and within schedule according to the terms of the contract. A descriptive model of the system showed the magnitude and complexity of the contract administration process. The chapter also showed however that there is a recent trend to shift towards a more simple process, which relies more on insight rather than oversight of contractors. Contract administrators are beginning to rely more on the contractor business and economic motivation to maintain commercial competitiveness through delivery of quality products or services at competitive prices.

The following chapter will present the analysis and interpretation of data gathered from the study of three AFP contracts, interview of important officials in the AFP Modernization Program and survey of officers involved in the modernization process.

IV. ANALYSIS AND INTERPRETATION OF DATA

A. INTRODUCTION

The preceding chapters demonstrate that the Armed Forces of the Philippines (AFP) does not have a single, comprehensive system to administer its modernization contracts. Captain Emilio C. Marayag PN(GSC), the Director of Naval Modernization Office, confirmed this during his interview when he said [17: Sec I],

The acquisition laws and regulations [in the Philippines] are not adequate. RA 7898 allows special treatment for defense acquisition but the implementing rules and regulations, though not inconsistent, do necessarily support each other.... The new acquisitions will start from keel laying to commissioning and we have not experienced anything like this before. While in the past the money spent on acquiring the ships comes from foreign military assistance, the future acquisition will use [Republic of the Philippines] RP funds. Thus, PN [or the AFP] must develop a contracting system to ensure the success of contract implementation.

Presently, the AFP Major Services have to adhere to different sets of regulations from different Government agencies in order to implement the contracts according to the intentions of the AFP Modernization Act, RA7898. Not one of the regulations, however, provides a complete and definite guidance for the major system acquisitions required in the AFP Modernization Program. Department of National Defense (DND) Circular 29 and General Headquarters (GHQ) SOP 2 provide details on how to formulate contracts, but do not give guidance on how to administer the contracts except for the preparation of the Program Status Report (PRSR). Nevertheless, as shown in Chapter II, the PRSR, by its format, indicates the emphasis of DND in the implementation of contracts. Another set of regulations is the Project Management Circular of each Major Service, but these guidelines are limited to monitoring production processes and standards. Only the

Government Accounting and Auditing Procedure of the Commission on Audit (COA) provides a comprehensive procedure for contract administration; however, it is generally limited to construction contracts. These four regulations, taken together, define the present Contract Administration process for the AFP Modernization Program pursuant to RA 7898.

In contrast to the Contract Administration System presented in Chapter III, the limitations of the AFP Contract Administration are evident. The system is fragmented, liable to misinterpretation and difficult to implement. It is incomplete and only marginally applicable for major system acquisitions. In essence, the AFP has no working system for administering its modernization contracts. It only has a mix of rules from different agencies that was forced on it by RA 7898. The AFP therefore needs a responsive contract administration system for its modernization projects. To develop this, we need to identify first the likely post-award issues that may emerge in association with the AFP Modernization Program.

This chapter provides the first step in developing a contract administration model for the AFP Modernization Program. It presents the analysis and interpretation of data from recent AFP contracts, interviews of important officials in the AFP Modernization Program, and a survey of officers involved or likely to be involved with the modernization. The purpose of the chapter is to extract and identify the post-award issues associated with the AFP Modernization Program. These issues are essential points for identifying the vital elements and characteristics of an appropriate model of contract administration for the AFP.

B. SOURCES OF DATA

The study has three sources of data and information, which it used to determine the underlying post-award issues associated with the AFP Modernization Program. These sources are recent AFP major system acquisition contracts, interviews of key officials in the AFP Modernization Program, and a survey of officers involved with the modernization process.

1. Recent AFP Major System Contracts

The AFP recently completed three contracts for major systems. First is the agreement between the Philippine Army (PA) and GKN Sankey Limited (GKND) of Great Britain, for the supply of 150 "Simba" Armored Personnel Carriers plus initial spare parts amounting to an aggregate price of about \$56 million [21]. The contract involved the delivery of ten "Simbas" from Great Britain, the assembly of another 140 vehicles in the Philippines, and the provision of initial spares worth more than \$5 million. The second contract is between the Philippine Air Force (PAF) and Agusta S.P.A. of Italy, for the supply of six S211 Jet Trainer Aircraft and 18 SF260TP Aircraft plus initial spares, ground support equipment, test equipment and special tools at about \$52 million [20]. The contract specified the delivery of four S211 and eight SF260TP from Italy, and the assembly of the rest of the aircraft in the Philippines. The last contract is the sales agreement between the Philippine Navy (PN) and the Ministry of Defense of the United Kingdom (UKMOD), for three Peacock Class Patrol Vessels at 6.75 million pounds [22]. The sale is on "as lying" basis, which includes on board spares and ammunitions.

It is only recently that the AFP resorted to contracting for weapon systems outside the U.S. Military Assistance Program (MAP) and Foreign Military Sale (FMS).

Essentially, the AFP at present completed only four non-MAP/FMS contracts, and of these, only three contracts are available for study. Among these, the PA and PN contracts were completed satisfactorily according to schedule, and the PAF contract is also progressing satisfactorily with the last installment due in year 2000. Indeed, as Brigadier General Lysias C. Cabusao, Director of the AFP Modernization Program Management Office, had pointed out in his interview, there are very few complications or difficulties that were encountered in the implementation of the three contracts presented [6: Sec IV]. Ironically, this good fortune deprived this study with actual examples of post-award issues, except in the areas of delivery, payment and contract modification. Nonetheless, despite this limitation, identification of the underlying post-award issues is still possible through analysis and projection from the terms and conditions of these three contracts.

2. Interviews with Key AFP Modernization Program Officials

Interviews of high-ranking AFP officials directly involved with the implementation of AFP modernization contracts were conducted using mailed questionnaires, Appendix A. The interviews were with Brigadier General Lysias C. Cabusao AFP, the present Director of the AFP Modernization Program Management Office [6], Captain Emilio C. Marayag PN(GSC), the present Director of the Naval Modernization Office [17], and Colonel Froilan M. Maglaya PA(GSC), the current Assistant Chief of Staff for Plans of the Philippine Army [15]. These interviews provide insight into the prevailing situation in the AFP Modernization Program. The interviewees are persons who are currently shaping the policies for the modernization of the AFP and their comments reflect the current views of the AFP leadership on the AFP Modernization Program. They are the current experts on the subject, and their constant exposure to the AFP modernization

process places them at the best position to identify the problems being experienced by the AFP in contract formation and performance. Therefore, their responses provide basis to define further the issues associated with the AFP Modernization Program.

Aside from the interviews, the researcher also received e-mail comments from other senior officials who have significant roles in the implementation of AFP modernization contracts. Together, the interviews and other correspondence are used in this study to accurately determine the post-award issues currently or most likely to be associated with the AFP Modernization Program.

3. Survey of AFP Officers

The perusal of the recent contracts and the interviews provide a good understanding of the working environment within which the AFP Modernization Program would be implemented. Specifically, the interviews identify the post-award issues that the AFP acquisition leadership believes to be critical for the successful completion of AFP modernization contracts, and indicate the approach they plan to take to address these issues. However, validation is necessary to verify whether the independent result of the study of the three AFP contracts and the comments made by the experts in AFP modernization truly reflect the prevailing situation or environment in the AFP acquisition field. The researcher, therefore, conducted a survey of AFP officers performing acquisition or acquisition related functions; 40 responses were received.

The survey tried to obtain responses from all the AFP officers currently involved, directly or indirectly, to the AFP Modernization Program. Out of the estimated population of 144 officers, 40 responded. The significance of this survey to the study is based on the assumption that the training and recent experience of these officers in major

systems acquisition and contracting provides them the basis for anticipating the post-award issues in AFP major systems acquisition. Some of them had experienced problems in contract modification, in dealing with Customs, in the obligation and release of funds, in foreign currency exchange and in remittance of payments to foreign suppliers that gave them a more or less clear understanding of the issues presently surrounding AFP acquisition in general. This training and experience gives them enough insight to determine intelligently the significant functions in AFP contract administration.

C. ANALYSIS AND INTERPRETATION OF DATA

Examination of the three contracts reveals several areas of concern in contract administration. These are Production Surveillance and Quality Assurance, Inspection and Acceptance, Warranty, Subcontracting and Technology Transfer, Security, Timeliness of Delivery, Countertrade, Promptness of Payment, Bonds and Liquidated Damages, Appropriate and Equitable Contract Modification, Expedient Contract Disputes Resolution, and Just Termination of Contracts. The process could have identified more post-award issues if not for the lack of supporting documents to these contracts. The AFP has no organized system for filing contracts and related documents. The lack of an organized document retrieval system makes it impossible to trace all the post-award transactions and decisions made by the parties, an issue that will be addressed later in this thesis.

On the other hand, the interviews confirm the areas of concern identified above and added Satisfactory Completion of Contracts and Government-Furnished Property as additional issues in AFP contract administration. The interviewees give insightful comments about the different processes in a contract administration system. They also

express the need for contract specialists in the AFP, but insist that these persons should be subordinate to the Project Management Teams in the implementation of AFP modernization contracts.

Essentially, the correlation of the responses of the interviewees with the result of the examination of the recent AFP contracts provides a clear comprehension of the post-award issues existing in the AFP modernization and acquisition process. However, this knowledge still has to be validated independently in order to confirm it truly reflects the prevailing situation or environment in the AFP acquisition field. To do this a survey was conducted among AFP officers; Table II shows the results.

Using a 68.1 percent cut-off for significance, the survey established that officers in the AFP acquisition field consider seven of the ten functions enumerated in the questionnaire, as relevant for the successful execution of the AFP Modernization Program. These functions are Product Surveillance and Quality Assurance, Inspection and Acceptance, Audit and Contractor Management Review, Financial Administration, Contract Modification, Contract Disputes Resolution and Contract Termination. The survey result, therefore, confirms most of the areas of concern in contract administration identified earlier and added Audit and Review of Contractor Management and Financial Administration to the list.

In summary, the analysis and interpretation of data, from the three sources mentioned earlier, resulted in 16 possible post-award issues that could impact the AFP Modernization Program, namely: (1) Production Surveillance and Quality Assurance, (2) Inspection and Acceptance, (3) Warranty, (4) Subcontracting and Technology Transfer,

Table II. Survey Responses on the Relevance of Enumerated Contract Administration Functions.

CA Function	Very Relevant	Relevant	Neutral	Irrelevant	Very Irrelevant	Don't Know Relevance	Don't Know Process
Product Surveillance and Quality Assurance	37 (92.5%)		2 (5%)				1 (2.5%)
Inspection and Acceptance	34 (85%)	2 (5%)	3 (7.5%)				1 (2.5%)
Supply Traffic and Transportation	16 (40%)	9 (22.5%)	6 (15%)	2 (5%)	1 (2.5%)	4 (10%)	2 (5%)
Audit and Review of Contractor Management	27 (67.5%)	8 (20%)	4 (10%)				1 (2.5%)
Financial Management	30 (75%)	7 (17.5%)	2 (5%)				1 (2.5%)
Government-Furnished Property Management	17 (42.5%)	6 (15%)	7 (17.5%)	3 (7.5%)	2 (5%)	3 (7.5%)	2 (5%)
Contract Modification	20 (50%)	12 (30%)	6 (15%)			1 (2.5%)	1 (2.5%)
Contract Termination	26 (65%)	7 (17.5%)	5 (12.5%)	1 (2.5%)			1 (2.5%)
Contract Dispute Resolution	21 (52.5%)	10 (25%)	7 (17.5%)				2 (5%)
Contract Closeout	21 (52.5%)	6 (15%)	6 (15%)	3 (7.5%)		1 (2.5%)	3 (7.5%)

Source: Developed by Researcher.

(5) Government-furnished Property, (6) Security, (7) Timeliness of Delivery, (8) Promptness of Payment to Contractors, (9) Countertrade, (10) Bonds and Liquidated Damages, (11) Efficient Financial Administration, (12) Appropriate and Equitable Modification of Contracts, (13) Expedient Resolution of Disputes, (14) Just Termination of Contracts, (15) Satisfactory Completion of Contracts, and (16) Audit and Review of Contractor Management System.

1. Production Surveillance and Quality Assurance

This particular issue is rated highly in the survey, with 92.5 percent of the respondents considering it as very relevant. The contract review, however, reveals that despite the importance of this issue, the AFP will generally rely on the quality control system of the contractor [20: Art 7.1.1.3]. The AFP has practically no oversight over a contractor's production process; the only control on quality is during the acceptance of the item. However, even then, the AFP may waive this right by instead relying on a written certification from the supplier that the item was inspected, tested and accepted according to the quality control process and standards of the manufacturer [21: Art 5.1-5.3]. This arrangement is expected considering the lack of resources and technical expertise in the AFP; presently, this may be the best alternative for the Philippine military and defense establishment. This situation, however, should not discourage the AFP from developing some degree of control over the production process, where appropriate, to reduce the risk of receiving poor quality products or services.

In their interviews, General Cabusao, Captain Marayag and Colonel Maglaya said that the AFP would manage the implementation of modernization contracts through the Project Management Teams (PMT), which will be formed for each of the modernization

projects [6: Sec I(1), 17: Sec I(1) & 15: Sec I(1)]. The PMTs will be responsible for the satisfactory performance of contracts under their cognizance. These teams would ensure that the contractor produces and delivers products or services according to the specifications stipulated in the contract. The Modernization Office of each Major Service would coordinate the activities of these PMTs and render appropriate progress reports to the AFP Modernization Program Management Office (AFPMPMO).

The interviewees admitted that the AFP has very few guidelines governing the process, and has practically no rules or regulations for the monitoring and surveillance of contractor production processes [6: Sec I(2), 17: Sec I(2) & 15: Sec I(2)]. Captain Marayag added that the AFP lacks the personnel and the expertise to perform production surveillance [17: Sec II(1)]. This poses a potential problem for the Philippine military; even if it hires consultants to determine whether the contractors are complying strictly with contract provisions or not, the AFP still has the ultimate responsibility for ensuring quality [17: Sec I(4)]. On this note, General Cabusao thinks that at the present skill level of most AFP personnel, the AFP has little technical ability to evaluate the production quality [6: Sec II(1)]. Additional training would be needed to make AFP personnel capable of effective surveillance of the contractor production process.

2. Inspection and Acceptance

Ninety percent of the survey respondents consider this issue important for the AFP modernization and acquisition process. As mentioned earlier, it is during inspection and acceptance that the AFP exercises control over the quality of products and services. The AFP can reject deliveries that do not comply with the specifications and thus control the quality of products or services the contractor should deliver. Unfortunately, the study of

the contracts shows that the AFP may tend to waive this right due to budgetary constraints, particularly for products manufactured overseas. The AFP may chose not to send test observers and rely instead on certified contractor test reports. [21: Art 5.3 & 20: Art 7.1.1.5]

Cost is the underlying reason for the Philippine Government's reliance on a manufacturer's quality control processes. However, the Philippine Government is aware of the possible detrimental effect of such reliance on product performance. It increases the possibility of acquiring defective items or services that could jeopardize the objectives of the acquisition and eventually the mission of the Armed Forces. It can even turn out to be more expensive because of the unnecessary costs incurred, in terms of time, money and effort, to replace or correct the defective product or service. Notwithstanding, the Government could avoid or mitigate the risk posed by such heavy reliance on contract quality control through careful application of prudent business principles. It is common knowledge that no contractor, especially large international firms, would risk their name and reputation by selling defective products or providing poor services. They know that by doing so they would eventually risk losing future Filipino business. In the end, however the interest of the Government may be better served by having the ability to inspect and test all critical products before accepting it. So long as the benefits outweigh the costs, the AFP should conduct hands-on testing of the products.

3. Warranty

The warranty terms of the contracts reviewed are 12-month commercial warranties that require a written notice from the buyer 30 days after discovery of the defect [21: Art 8 & 20: Art 11]. The warranties also include initial spare parts and special tools. The

issue on warranty is in the implementation. The end-users are usually in the most advantageous position to report product defects. However, they are also the least informed about the warranty provisions. Usually, the user would fail to report the problem on time, or worse, attempt to repair the product themselves either because of operational exigency or because of plain ignorance. In either case, the warranty is voided and the Government loses the warranty's benefits despite having paid a premium for it.

4. Subcontracting and Technology Transfer

The concern of the AFP on this matter is the effective transfer of technology from the foreign contractor to the Philippines, which is a requirement of the AFP Modernization Act, RA 7898 [10: Sec 10]. Like countertrade, this plan has economic benefits, in terms of higher employment and human capital development for the Philippines. All the contracts reviewed have this element in the form of in-country co-production arrangements. In the PAF contract, the contractor was required to subcontract the assembly of some of the aircraft to the Philippine Aerospace Development Corporation (PADC) [20: p 3]. In the PA contract, the manufacturer, GKND, entered a joint venture with a local firm (PHIVIDEC), for the assembly of "Simba" APCs in the Philippines [21: p 1]. They formed a jointly owned company, Philcorp, to assemble the vehicle from kits supplied by GKND. Quality assurance is the main concern in this issue. The follow-on items produced locally, after the technology transfer, must have the same quality as those produced abroad by the contractor. The technology transfer arrangement should also foster the enhancement of the quality of the local workforce. Basically, good working relationships among the contracting parties and the local subcontractors must be maintained in the arrangement to make it work and minimize risks (potential reduction in

product quality, possible breach of licensing agreement or potential losses in capital investment) to those involved.

5. Government-Furnished Property

In their interviews, General Cabusao and Captain Marayag clarified the issue of government-furnished property [6: Sec II(4), 17: Sec II(4)]. They suggested the title or ownership of sub-systems or sub-assemblies, before the completion or delivery of the products, should belong to the prime contractors. Most, if not all, of the contracts will be fixed-price type since the AFP, as per policy, is required to obtain only non-developmental products or systems. In this case, the AFP will not have ownership of components. It is only after delivery of the final product or system that ownership transfers to the AFP.

These comments downplay the relevance of government-furnished property (GFP) as a post-award issue in the AFP Modernization Program. Captain Marayag, however, clarified that the AFP might furnish Government equipment for contracts performed locally [17: Sec II(4)]. The AFP most probably does not have any equipment, material or facilities that would be needed by contractors in their production process. However, in the event that there would be Government property needed by a contractor, it would be treated as a regular Government-property issuance transaction. In this arrangement, the contractor will sign a Memorandum Receipt (MR) to be issued by the logistics officer of the cognizant PMT. The logistics officer would then become the officer accountable for the property, while the contractor would be accountable to him as custodian of the property.

6. Security

The PA and the PAF interest on security concerns the safeguarding of classified military documents that may be supplied to the contractor in the course of the execution of the contract [21: Art 17 & 20: Art 23]. It involves procedures in handling, use, storage and protection of classified documents by the contractor. On the other hand, the Navy PCPV contract concerns more about the security of classified materials passed on to PN by the Royal Navy in connection with the sale of the Peacock class vessels [22: Sec XI]. As a post-award issue, the focus may deal more closely on the proper marking and safekeeping of the classified materials.

7. Timeliness of Delivery

The PA and PAF contracts required delivery to the user on a C.i.f. destination (cost of transportation and marine insurance paid by the contractor) basis [21: Art 6 & 20: Art 6]. All fees, taxes, duties, etc., in the source country will be paid and handled by the seller, but fees, taxes, duties, etc., in the Philippines will be the responsibility of the AFP [21: Art 10 & 20: Art 5].

Delivery could be a major concern for the AFP Modernization Program since most of its weapon acquisitions will be importation. The AFP has very little experience in this process, and the impact of this lack of experience with Philippine Customs procedure may be significant. For example, the lack of experience with Philippine Customs cost the Army considerable delay in the release of the first shipment of "Simba" APC from the port of entry [40]. Major Vicente Yordan PA, the Chief of the PA Modernization Branch said that the Army only learned of the nuances of the custom procedures when it

experienced processing problems at the port of entry. Now, the Army knows that it would be more expedient to hire customs brokers to do the work for them. [40]

In a similar situation, ignorance of the Government importation and financial bureaucracy ruined the chance of the Philippine Navy to acquire its first missile boat in 1992 [1]. Of course, other factors influenced the cancellation of the missile boat, but the point is the AFP needs to establish the appropriate organization and procedure to address the issue of delivery and importation. If not, this problem could result in costly delays to both the Government and the contractor. The AFP may not receive the equipment on time to meet pressing operational needs, or the contractor may not receive the necessary materials on time to meet its in-country production schedule.

8. Promptness of Payment to Contractors

This concerns the Government's primary obligation in contracts, which is the timely and appropriate payment of bills to contractors. Payment delays could compel contractors to avoid doing business with the AFP, or to a lesser extent impose penalties and conditions that may make future procurement too risky and costly for the Government. Delays in payment are avoidable, but require close coordination among Government agencies. The PN contract is a good example of delay in payment. In this case, the first installment was delayed due to poor coordination between the Philippine Navy and the Department of Budget and Management (DBM) [7]. The request for obligation was not given priority and it was too late when the Navy followed-up on the status of the request. Consequently, the first installment, amounting to 2.025 million British Pounds (GBP 2.025 million) and due on 31 March 1997 [22: Sec VII], was paid

late on 1 May 1997. From then on, the PN was placed in a disadvantageous position in dealing with its British counterpart until the completion of the contract. [13]

Another problem in payment is the volatility of the exchange rate. Most of the major system acquisitions are importation paid in US Dollars or other foreign currency, but local fund releases are in Philippine Pesos (PHP). Thus, there must be an elaborate procedure involving local and foreign banks for the remittance of payments overseas. In the PN PCPV contract for example, DBM released the equivalent PHP 87.075 million for the GBP 2.025 million first installment, which was computed based on the exchange rates of \$1.65 to GBP 1.00 and PHP 26.06 to \$1.00. However, when the amount was later remitted to the U.K., the exchange rate fluctuated to PHP 26.39 to \$1.00, forcing the Government to pay PHP 1,100,587.50 more for the GBP 2.025 installment. [25] The Government ended up paying more because of the unexpected and unfavorable change in the foreign currency exchange rate.

In his interview, Colonel Maglaya stated that payment would involve the Finance and Accounting units of the Major Services for the accounting and payment of contractor invoices [15: Sec II(3)]. It may also involve the Commission on Audit (COA) for conducting post-audit of transactions between the AFP and the contractor. Colonel Maglaya believes the COA has the mandate and the resources to audit contractors [15: Sec II(3)], but Captain Marayag disagrees since the COA has not performed audit of contractors, especially foreign firms, beyond the sales invoices [17: Sec II(3)]. However, both officials advocate the strengthening of the existing accounting system to meet the financial support requirements of the AFP Modernization Program. They argue that considering the substantial amount of money that will be invested in the Program, the

AFP needs to formulate better financial policy congruent with rules and regulations promulgated by the COA [17: Sec II(3) & 15: Sec II(3)].

Therefore, timeliness of payments made by the AFP may affect its future dealings with contractors. Delayed payment of contractual bills would discourage contractors from doing further business with the AFP. The contractor would incur some cost due to capital tied up in AFP projects. Unless a contractor is paid promptly, costs could accumulate and negatively affect his business. With this experience, it is highly likely that a contractor will avoid future business with the AFP. If this becomes the commonplace, the AFP could find itself unable to muster adequate competition for bidding on future acquisitions. Without competition, the AFP may lose the ability to obtain quality products or services at a fair and reasonable price.

9. Countertrade

The PAF contract requires that 60 percent of the payment to the contractor be made through a countertrade arrangement technically known as counter-purchase [20: Art 24.3]. The modernization law requires countertrade and is required in all Government contracts with foreign suppliers. This arrangement is essential for countries with poor economies, since they must conserve their foreign exchange reserves. In the PAF contract, 60 percent of the payment to Agusta is through counter-purchase, wherein payment will be in terms of exported goods instead of hard currency. The arrangement will involve two trading companies, one in Italy and another in the Philippines. Instead of making payment directly to Agusta, PAF will pay the local trader in Pesos, for the equivalent value of goods it exported to Italy. The Italian importer who receives the goods in Italy will then pay Agusta, instead of the Filipino trader, in Lira. The

arrangement should ensure that the amount of Pesos paid by PAF and the amount of Lira received by Agusta is equivalent to the contract price.

The first concern in countertrade is how to make the arrangement fair to both parties. The arrangement could cause undesirable variation in the amount and timeliness of payments that could place either party at a disadvantageous position. Miscommunications, foreign exchange fluctuations and delays in remittances may cause discrepancies in the amount of money actually received by the contractor. The contractor may end up either slightly under-paid or over-paid. Either way, the AFP would end up on the losing end. If the contractor ends up over-paid, the AFP loses some money. If the contractor on the other hand is under-paid, the AFP bears the cost of less efficient acquisition in the future due to possible lack of offerors or competition. Contractors will be deterred from doing further business with the AFP because of the risk of ending up under-compensated for the products or services they delivered. The countertrade arrangement must be simple and carefully orchestrated to avoid the above problem.

Another concern associated with this issue is the involvement of the Philippine International Trading Corporation (PITC), which is the only trading company authorized by the Government to conduct countertrade for Philippine Government Agencies. The interviewees confirmed that the AFP has no control over the PITC in the implementation of Countertrade Agreements [6: Sec III(1), 17: Sec III(1) & 15: Sec III(1)]. In fact, the AFP is not in the position to give any assurance to its contractors that they will not be burdened by the arrangement. As indicated, only PITC is in the position or has the expertise to deal with the countertrade positions of the parties involved.

Finally, Captain Marayag further explained in his interview that he sees reasons for some problems to arise in countertrade [17: Sec III(4)]. The contracting process requires PITC to rank and evaluate the offerors' countertrade proposals, independent of the AFP's evaluation and ranking of the contract proposals. There is great likelihood that the offeror ranked highest in contract proposal by the AFP may not receive the same ranking in the PITC countertrade evaluation. The AFP could end up with a contract with a marginal or even an undesirable countertrade arrangement. If this happens, then the faulty countertrade arrangement with this winning offeror may adversely affect the execution of the contract later.

10. Bonds and Liquidated Damages

The contracts reviewed also emphasize the significance of Performance Bonds in the execution of a contract. The PAF contract requires the placement of a Performance Bond by the contractor before the first down payment [20: Art 4.1.1]. The Army contract, on the other hand, required not only a Performance Bond but also required an Advance Payment Bond before the first delivery [21: Art 14]. These security instruments protect the buyer from non-performance by the contractor. This is vital for the Philippine Government; considering its financial difficulties, the Government needs protection from losses from failed projects. However, requiring bonds could also cause delays in the execution of a contract. In fact, disagreements on the implementation of Bonds, among other reasons, contributed to the suspension of the acquisition of Multi-role Fighter Aircraft for the PAF [1]. Admittedly, most delays would be less dramatic than the PAF case, but waiting for the contractor to file the bond may constitute a delay in starting a particular modernization project. Similarly, Government delay in returning bonds to

contractors may also constitute a delay in concluding a contract. Unless the AFP develops an appropriate administrative procedure, bonds may cause administrative problems in starting or closing a contract.

For liquidated damages [21: Art 16 & 20: Art 13], the AFP concern is with implementation. This obligation applies primarily to the failure of the supplier to deliver the product on time. The AFP does not have a set of procedures to monitor delays and initiate claims for damages associated.

11. Efficient Financial Administration

The survey indicates that 92.5 percent of the respondents consider this issue as vital for the administration of AFP modernization contracts. Financial administration ensures the proper implementation of all financial transactions supporting the contract. This involves the prompt obligation of funds and remittance of all payments to contractors. Conversely, it also involves the appropriate collection of applicable bonds, warranty restitution, if not in kind and accrued liquidated damages from contractors. Also included in this issue is the appropriate action of the AFP in cases of financial difficulties or bankruptcy of the contractor. Essentially, this issue will entail the implementation of financial transactions between the AFP and the contractors according to all applicable accounting and auditing rules of the Philippine Government.

12. Appropriate and Equitable Modification of Contracts

The survey indicates that 80 percent of the respondents consider this issue important to the AFP modernization and acquisition process. In the contracts studied, modification of contracts is allowed only through supplementary agreements between the contracting parties. The AFP has no unilateral rights to change any provision of the

contract. The modification of a contract can be initiated by a Change Request from either party. However, the contract could only be altered if the other party consented to the proposed modifications and the resultant agreement reached is formalized in writing. The AFP contract administration issue regarding contract modifications is how to properly adjust the contract price to accommodate the agreed upon changes, without giving an undue advantage to either party.

In his interview, General Cabusao stressed the significance of this factor in contract administration, and he suggested that the contract negotiation officers of the cognizant Bids, Awards and Negotiations Committee (BANC) would perform this function [6: Sec II(5)].

Colonel Maglaya related the Army's experience with the "Simba" APC contract modification, particularly in the technical specification of the engine and the contract delivery schedule [15: Sec IV(1)]. There are no established rules on how to proceed with the process, except for the contract variation provision in the contract itself. If not for the frequent and regular meetings of the Simba Project Management Group (SPMG), which includes GKND representatives, the problems would not have been recognized and addressed by the parties to allow timely adjustment of the contract specifications [15: Sec IV(2)]. Colonel Maglaya, however, stressed in agreement with General Cabusao's statement, that all revisions of modernization contracts should be referred to General Headquarters (GHQ), AFP since all these contracts are finalized and approved at GHQ/DND level [15: Sec II(5)].

Captain Marayag also advocated a responsive contract modification procedure [17: Sec II(5)] because changes in surrounding context, priorities or technology are likely to

happen and could make the original contract inapplicable, relatively more costly, or technologically obsolete. Therefore, a contract modification procedure would be needed to ensure the orderly adjustment of contracts without unnecessarily disturbing the contractual relationship between parties. However, he suggested that the PMTs are the appropriate entity to manage the contract modification process [17: Sec II(5)].

This study supports the argument of Captain Marayag that the PMT and not the BANC should handle contract modifications, including the consequential negotiations. The BANC is an Ad Hoc Committee that is disbanded after contract award. It may not be cost effective to reactivate it just to negotiate modifications, especially minor changes. Thus, it would be best to delegate this function to the PMT. However, approval of contract modifications and equitable adjustments by the PMT must be limited to minor changes only. The AFPMPMO at GHQ should approve major modifications above a predetermined threshold.

13. Expedient Resolution of Disputes

This issue, which 77.5 percent of the survey respondents consider as important to AFP contract administration, centers on the procedure to resolve claims and disputes. In all the contracts reviewed, the preferred method is by arbitration using the Rules of Conciliation and Arbitration of the International Chamber of Commerce to be held in a predetermined third country [21: Art 22, 20: Art 18 & 22: Sec XIX]. The PA contract requires that arbitration could only be resorted to after 60 days of settlement negotiations between the parties. Presently, however, the AFP has no administrative procedure to take advantage of such 60-day period to act on and preferably settle a claim with the contractor before arbitration. An interim dispute resolution process could save the AFP

and the contractor a considerable amount of money and effort through avoidance of costly and time-consuming third party arbitration or litigation.

In their interviews, General Cabusao, Captain Marayag and Colonel Maglaya confirm the need for the AFP to have a mechanism to resolve disputes with contractors [6: Sec II(6), 17: Sec II(6) & 15: Sec II(6)]. An internal process would be more expedient and less costly for both the Government and the contractor. Captain Marayag indicated that the AFP Judge Advocate Service could perform this function. However, he doubts whether the military will have enough resources in terms of time, money and personnel, to perform the process [17: sec II(6)]. General Cabusao said that disputes resolution would be handled at the DND level [6: Sec II(6)]. A special body will be formed to handle contract disputes.

The main concern regarding this issue is how to maximize the chance of an amicable settlement during the 60 days before the contract dispute is brought to a neutral international body for arbitration, or later to a court for litigation. It would be prudent for both parties to seek amicable settlement to avoid not only the cost of arbitration or litigation, but also the cost resulting from delays or work stoppages. In this case, the AFP should establish a procedure to hear claims and appeals of contractors and decide judiciously on the merits presented before arbitration or litigation. Since contracts are approved at DND, the most logical approach would involve the establishment of a special body at DND to hear contractual disputes.

14. Just Termination of Contracts

The survey shows that 82.5 percent of the respondents consider this issue as relevant to the AFP modernization and acquisition process. In fact, all the contracts

reviewed have provisions for early termination due to breach or default by one of the parties [21: Art 18, 20: Art 19 & 22: Sec XV]. Essentially, this issue has two aspects. The first one concerns the procedure for canceling the contract due to default of either party. In the contracts studied, termination proceedings require the serving of a 90-day notice to the breaching party by the other party, citing therein the reasons for ending the agreement. This notice allows the breaching party time to improve performance, and thereby, avoid termination. Terminations of contracts are inherently costly to both parties in terms of wasted time, money and effort. That is why contracting parties try to avoid termination as long as their individual interest in the agreement is not violated.

The second aspect is termination for convenience of the Government. The AFP has not applied this principle to its contracts. However, examination of the force majeure clause showed that the process is actually allowed because this clause includes actions of Government entities that could render a contract non-enforceable [21: Art 15, 20: Art 12 & 22: XIII]. In this case, the Government, by virtue of events that render the products or services useless or no longer needed, could terminate the contract provided the contractor is compensated for the cost of all work completed. In totality, the AFP concern in this area is the establishment of an orderly procedure to protect the interest of the Philippine Government without unjustly harming the contractor.

15. Satisfactory Completion of Contracts

In his interview, Captain Marayag provided another issue in AFP contract administration. His comments on contract closeout gave some insights into this process. According to Captain Marayag, the AFP has not in the recent past, entered into contracts involving international defense suppliers. Any good or relevant information derived from

doing business with such suppliers is better than having nothing [17: Sec II(8)]. A contract closeout process will be something new to those who would implement the contract. The procedure stipulated for the process will serve not only as guidelines for them but also as initial source of information about contract closeout.

Two-thirds (67.5 percent) of the respondents consider Contract Closeout as relevant to the AFP Modernization Program. The AFP has to protect the interest of the Government throughout the duration of the contract; a thorough contract closeout procedure would ensure this for the AFP. It would be in the best interests of both parties to close a contract completely. The parties must be satisfied that all requirements in the contract are carried out, i.e. all the items have been delivered and all payments have been properly paid. More so, contract closeout will ensure that there are no pending modifications or termination proceedings, and that all countertrade obligations are carried out satisfactorily.

16. Audit and Review of Contractor Management System

The survey reveals that 87.5 percent of the respondents rate this issue as relevant to the AFP modernization and acquisition process. The high rating of this function could be attributed to the officers' emphasis on the quality of contractor performance. This signifies that the AFP should have a better oversight system to gain greater control over the contractor production process, and ensure the timely delivery of products and services according to the specification in the contract.

The Philippine Constitution requires that all Government transactions should be post-audited by the Commission on Audit [19: pp 122-123]. The issue here is the extent of the mandate's coverage over foreign contractors and the availability of resources to

perform extensive audit of contractor cost accounting systems. It is anticipated that the AFP will award only fixed-priced type contracts for its equipment and systems acquisition. Thus, only limited audit of contractors' cost accounting systems may be required. The COA audit would be conducted to ascertain the correctness and completeness of invoices billed to the Government. However, this does not preclude the Commission from requiring thorough audit of contractors involving cost-reimbursement type contracts or when it deemed necessary to assess correctly the contractual transactions made between the AFP and its contractors.

The AFP may have to conduct significant review of a contractor's management systems to compensate for its limited in-plant production surveillance due to lack of manpower and resources. A thorough review of the production process, quality control system, accounting and administrative system of the contractor will give the AFP a good picture about the capability of contractor. The AFP could then ascertain whether the contractor could provide the required products or services according to the specification of the contract. Subsequently, it could initiate actions to ensure compliance of the contractor to the contract.

17. Special Issues

The issues discussed below are not entirely post-award issues, but are included here because these could greatly affect the administration of AFP modernization contracts. These exerted some influence during the discussions on some of the above post-award issues that made them relevant for the development of the Contract Administration Model most appropriate for the AFP Modernization Program.

a. Documentation of Post-award Activities

As mentioned earlier, this deficiency appears to be prevalent in most AFP offices. It is imperative for the AFP to document all its contracting activities, both pre-award and post-award, in order to maintain a complete history of each contract transaction. Documentation would provide an official paper trail to facilitate research, audit and investigation for process improvement and provide evidences for settling contract disputes.

b. Early Establishment of Project Management Teams

The AFP acquisition regulation delegated the administration of contracts to the cognizant PMTs [6: Sec I, 17: Sec I & 15: Sec I]. The above discussions on the various post-award issues also suggest that the PMTs will play a crucial role in the administration of AFP modernization contracts. The particular concern here is the late activation of the teams, which occurs after contract award. This practice places the teams in a disadvantageous position relative to their counterpart in the contractor organization. The latter would become relatively more experienced and knowledgeable about the details of the contract than the AFP PMTs. This may give the contractor representatives a psychological advantage that may allow them "greater influence" over the performance of the contract to the detriment of the Government interest.

To avoid this problem, the PMTs should be formed at the initial stage of the project, preferably before the determination of operational requirements. The PMT should be a matrix organization composed of members from strategic planning, logistics, engineering, legal, and comptroller functional areas. The team would be headed by a Project Management Officer selected from the appropriate engineering field and assisted

by a logistician with adequate contracting background or experience. All expertise needed for the effective and efficient management of projects and contracts would be provided to each team. However, if this were not possible due to personnel constraints, the experts would be pooled in the Major Services Modernization Program Management Offices (MPMO).

c. Control of the Cost of the Acquisition Process

In the above discussions of the post-award issues, the control of cost and conservation of procurement manpower and resources turned out to be a critical factor for the AFP Modernization Program. The Philippine Government, especially the AFP, has limited resources to provide complete oversight of contractor performance. It has an inadequate number of personnel, very little expertise and insufficient funds to conduct production surveillance and monitoring. In this regard, the AFP would most likely follow the developing trend in Contract Administration to rely more on contractor insight than oversight.

D. POST-AWARD ISSUES ASSOCIATED WITH THE AFP MODERNIZATION PROGRAM

The above discussions identified sixteen possible post-award issues that could be associated with the AFP Modernization Program. However, a closer look at these issues suggests the existence of more general post-award concerns, under which the related issues could be consolidated. The above analysis suggests quality of products and services, timeliness of deliveries, and promptness of payments are the most important issues around which some of the lesser issues revolve. This is expected considering that these outcomes are the primary objectives of most contracts. However, other issues, like

contract modification, disputes resolution, contract termination, contract closeout, financial administration and audit are also important since many contracts could not have been completed satisfactory if not for these supporting activities. In addition, other issues surfaced during the analysis that could affect the administration of AFP modernization contracts; these are documentation, early establishment of PMT and administration cost control. Based on the foregoing analysis, the 16 issues are reduced to the following 12 essential post-award issues associated with the AFP Modernization Program.

1. Quality of Product and Services

This research revealed that the AFP emphasizes the delivery of products or services by the contractor according to the specification written in the contract. However, the AFP lacks the resources to conduct complete oversight of contractor production process and may have to rely instead on the contractor's quality control system and certification to assure product quality. In this regard, the AFP may have to strengthen the following functions and procedures to:

- a. Review the contractor production and management systems before and during contract performance,
- b. Require AFP representatives to witness and confirm all product tests conducted by the contractor,
- c. Require inspection of products and services by AFP representatives before acceptance,
- d. Maximize the benefit of product warranty through active involvement of end-users particularly in prompt reporting of defects discovered,
- e. Monitor technology transfer to local subcontractor or partner, and

f. Provide management of government-furnished property and classified or proprietary information/data early in the contract administration process.

2. Timeliness of Delivery

The contractor should be encourage to devise the best possible production process to ensure timely delivery. This would involve the vigorous application of the Liquidated Damages clause to preclude delay by the contractor. In similar manner, the AFP should also improve its management of cargo shipments, particularly in the processing of contracted items and materials at the port of entry. Adequate coordination must be made with cognizant Government agencies to ensure the prompt payment of fees, duties or taxes and timely release of the item from the port.

3. Promptness of Payment

The contractor must be paid on time, commensurate to the products or services he delivered even if payment is through countertrade arrangements.

4. Efficient Financial Administration

The Government must ensure the proper implementation of all financial transactions related to the contract including collection and surrender of bonds, collection or payment of liquidation damages, collection of warranty restitution, and protection of Government financial interest in case of contractor bankruptcy.

5. Appropriate Contract Modification and Equitable Adjustment of Price

This issue concerns the revision of the contract due to changes in priorities, production process limitations or improvements, product changes, improvements in technology or other unforeseen events or circumstances that render the original contract provisions obsolete, unresponsive, inappropriate or places one party, especially the

Government, at a disadvantageous position. The modification process should result in an equitable adjustment in contract price or schedule.

6. Expedient Resolution of Disputes

The AFP must establish a contract disputes resolution process that settles efficiently and judiciously all contractors' claims and contract disputes within the AFP hierarchy, formalizes negotiation for amicable settlement before arbitration or litigation and provides an orderly procedure for elevating cases to the Judicial Courts.

7. Just Termination of Contracts

The study shows that the Government could and would be better off to have the right to terminate the contract for convenience and protect the public from useless expenditures. Furthermore, this issue calls for a procedure to terminate the contract due to default of one of the contracting parties primarily to protect the offended one.

8. Satisfactory Completion of the Contract

The Government must adopt a procedure to complete all requirements of the contract according to the satisfaction of the Government and the contractor.

9. Audit of Contract Transactions

This issue concerns the establishment of a process to audit adequately each contract transaction and the contractor, when needed.

10. Documentation of Post-award Activities

It is imperative for the AFP to document all its contracting activities; both pre-award and post-award, in order to maintain a complete history of each contract transaction.

11. Early Establishment of Project Management Teams

The PMTs must be formed at the initial stage of the project, preferably before the determination of operational requirements.

12. Control of the Cost of the Acquisition Process

The AFP has to conserve the manpower and resources available to its acquisition system. Cost is a critical factor in determining the appropriate contract administration model for the AFP Modernization Program.

E. SUMMARY

The above analysis suggests there are 12 post-award issues to be addressed in the AFP Modernization Program. Among these, the quality of product or services, timeliness of delivery and promptness of payment are the more important issues. The issues were derived from the examination of the three recent AFP contracts for weapon system acquisition, interviews of key officials involved with the AFP Modernization Program, and a survey of officers involved or likely to be involved in the AFP modernization process.

Interestingly, some of the issues deal with the inadequacy of the AFP in acquisition, particularly in terms of resources, organization and administration. There are also some concerns about the issues on audit of contractor production cost, composition and establishment of the PMT, extent of Government oversight and documentation of contract administration activities.

In the next chapter, these post-award issues will be used as basis for the development of the appropriate Contract Administration Model for the AFP Modernization Program.

V. MODEL OF CONTRACT ADMINISTRATION FOR THE AFP MODERNIZATION PROGRAM

A. INTRODUCTION

This researcher identified, in Chapter IV, twelve essential post-award issues associated with the AFP Modernization Program. This chapter presents the Contract Administration Model developed to address these issues. It shows the vital elements, characteristics and processes of the model that makes it applicable to the AFP modernization context.

B. ESSENTIAL CHARACTERISTICS AND ELEMENTS OF THE AFP CONTRACT ADMINISTRATION MODEL

A model of contract administration for the AFP Modernization Program should have attributes applicable to Philippine contracting. In the preceding chapter, the researcher identified twelve essential post-award issues using data gathered from AFP contracts, interview of key officials in the AFP Modernization Program and survey of AFP officers involved in major systems acquisition. These issues reflect anticipated conditions in AFP acquisitions. Thus, any characteristic or element generated from these post-award issues would likely apply to Philippine or the AFP context of acquisition and contracting.

The analysis presented in Chapter IV is sufficient to generate the necessary elements and characteristics of a contract administration model. However, this model could be further refined if the knowledge gained in Chapter II, regarding the pertinent statutes and regulations bearing on the AFP Modernization Program, and Chapter III, regarding the factors and trends in Contract Administration, are considered in the

analysis. This way, the model built from the characteristics and elements identified in the analysis would not only be responsive to address AFP post-award issues, but also flexible enough to adapt to contract management trends and enforceable under Philippine statutes, particularly RA7898.

Presented below are the essential characteristics and elements of a model of contract administration for the AFP Modernization Program, which were derived using the preceding inference and analysis.

1. Essential Characteristics of the Model

The following are the essential characteristics of the model of contract administration best suited to address the AFP post-award issues according to the Philippine acquisition context:

- a. The model is structured to allow more reliance on contractor insight than Government oversight for the timely delivery of right quality products and services to the AFP.
- b. The model facilitates review and audit of contractor production, accounting and management systems early in the contract administration process to ensure satisfactory contractor performance throughout the execution of the contract.
- c. The model permits product testing by the contractor provided the activity is witnessed and the results verified by the AFP.
- d. The model ensures the effective transfer of essential technology to the Philippines and the proper implementation of the countertrade arrangements required for all contracts with the Philippine Government.

e. The model is structured to promote prompt payment to contractors, facilitate control of contract cost, expedite collection of bonds and liquidated damages, and ensures quick and proper contract closeout.

f. The model promotes interaction between the end-user and the PMT to enhance feedback from the field regarding the operational performance of the product, and facilitate prompt application of warranty when needed.

g. The model is structured to encourage administrative resolution of contract disputes within the normal 60-day grace period provided in most AFP contracts before resorting to ADR arranged by the International Chamber of Commerce.

h. The model is structured to encourage the establishment of PMTs before the determination of the operational requirements, and maintain the PMT throughout the life cycle of the project.

i. The model functions with the least amount of manning and resources.

j. The model allows incorporation of innovative approaches to contract administration.

2. Essential Elements of the Model

Based on the characteristics enumerated above, the necessary elements of the model that would produce or manifest these desired attributes are isolated and identified. The model should be composed of rules, procedures, and organizations that when combined would possess the qualities that best address the post-award issues associated with the AFP Modernization Program. In this case, the elements must contribute positively to the formation and performance of AFP major systems acquisition contracts.

In view of the above, the elements for the contract administration model are grouped into three major categories: Statutes and Regulations, Key Organizations, and Standardized Procedures. The Statutes and Regulations category include the body of laws that will govern the conduct of contract administration. The Organization category is comprised of the different entities tasked to perform contract administration or related activities. The third category is the collection of Standardized Procedures for the adequate and appropriate conduct of various contract administration activities.

The following are the essential elements of the Contract Administration Model for the AFP Modernization Program:

a. Statutes and Regulations:

(1) AFP Modernization Act (RA 7898). Republic Act Number 7898 is the primary law from which the AFP receives its authority to procure weapon systems and equipment for the modernization of the military. Pursuant to this law, DND is obligated to promulgate policies and regulations to govern the formulation, execution and administration of acquisition contracts under the AFP Modernization Program.

(2) COA Government Accounting and Auditing Procedure. This is the primary regulation that governs all financial transactions and contracts of the Government. The Commission on Audit is a constitutional body created to audit all Government transactions [19: pp 122-123]. COA promulgated this regulation pursuant to the provision of the Philippine Constitution in order to standardize all Government business transactions. This study, however, ascertained that this regulation is inadequate to cover the major systems acquisitions intended for the AFP modernization. Nevertheless, the applicable provisions of the COA regulation will remain enforceable

over all AFP acquisitions and contracts pursuant to the spirit of the Constitution and RA 7898.

(3) DND Circular Number 29. Circular 29 is the primary regulation that governs all modernization activities of the AFP, including equipment and major systems acquisition and contracting. The Circular covers the formation of AFP contracts, but gives only token guidance for its execution. Recent experience of the AFP in the execution of its major system contracts, however, demonstrates that the Circular is inadequate and needs some changes to expand its coverage over post-award contract activities. Once amended, Circular 29 would then be the primary regulation governing the formulation and administration of AFP modernization contracts.

b. Key Organizations:

(1) Modernization Program Management Offices. These units (one in GHQ and one in each Major Service) are primarily tasked with the execution and administration of the AFP Modernization Program. These units would establish Project Management Teams (PMTs) for each modernization project and monitor the PMT's activities from inception to completion of their cognizant projects.

(2) Project Management Teams. These units, which are formed for each project, have primary responsibility for the execution, administration and completion of cognizant modernization projects. Primarily a matrix organization composed of different functional experts from operations, logistics, finance, engineering and legal. Preferably headed by an engineer, the team would be involved throughout the life cycle of the project. The PMT is the primary entity in the AFP modernization organization that would perform contract administration.

(3) DND Contract Appeals Board. A special board will be formed at DND level to hear and decide contractual claims and disputes resulting from AFP acquisitions. The Board will not perform contract administration functions, however, its resolution of contract disputes may impact contract performance.

(4) Major Services Finance and Accounting Units. These units are tasked to support the execution and administration of the financial aspects of the AFP modernization contracts. These organizations are primarily involved in the payment of contractors, collection and disposition of bonds and liquidated damages, and other financial services in support of the contracts.

(5) Resident COA Auditing Offices. These are COA agents that would perform audit of contractors and contracts in support of the AFP Modernization Program.

c. Contract Administration Procedures:

The Model of Contract Administration for the AFP Modernization Program must have a set of standardized procedures to ensure the proper and uniform execution of acquisition contracts throughout the AFP. These procedures were described earlier in the previous chapters. Essentially, these procedures would be modified to suit the unique requirements of the AFP Modernization Program. The contract administration processes will be tailored to minimize implementation cost and reduce manning requirements. Enumerated below are the various procedures determined to be vital for the proper administration of AFP modernization contracts; they will be discussed in the following section:

(1) Post-Award Orientation

- (2) Contractor Management Review
- (3) GFP Management
- (4) Contract Performance Monitoring
- (5) Inspection, Test and Acceptance
- (6) Delivery and Receipt
- (7) Auditing
- (8) Payment and Accounting
- (9) Collection of Bonds and Liquidated Damages
- (10) Application of Contract Warranty
- (11) Contract Modification
- (12) Claims and Disputes Resolution
- (13) Contract Termination
- (14) Contract Closeout

C. MODEL OF CONTRACT ADMINISTRATION

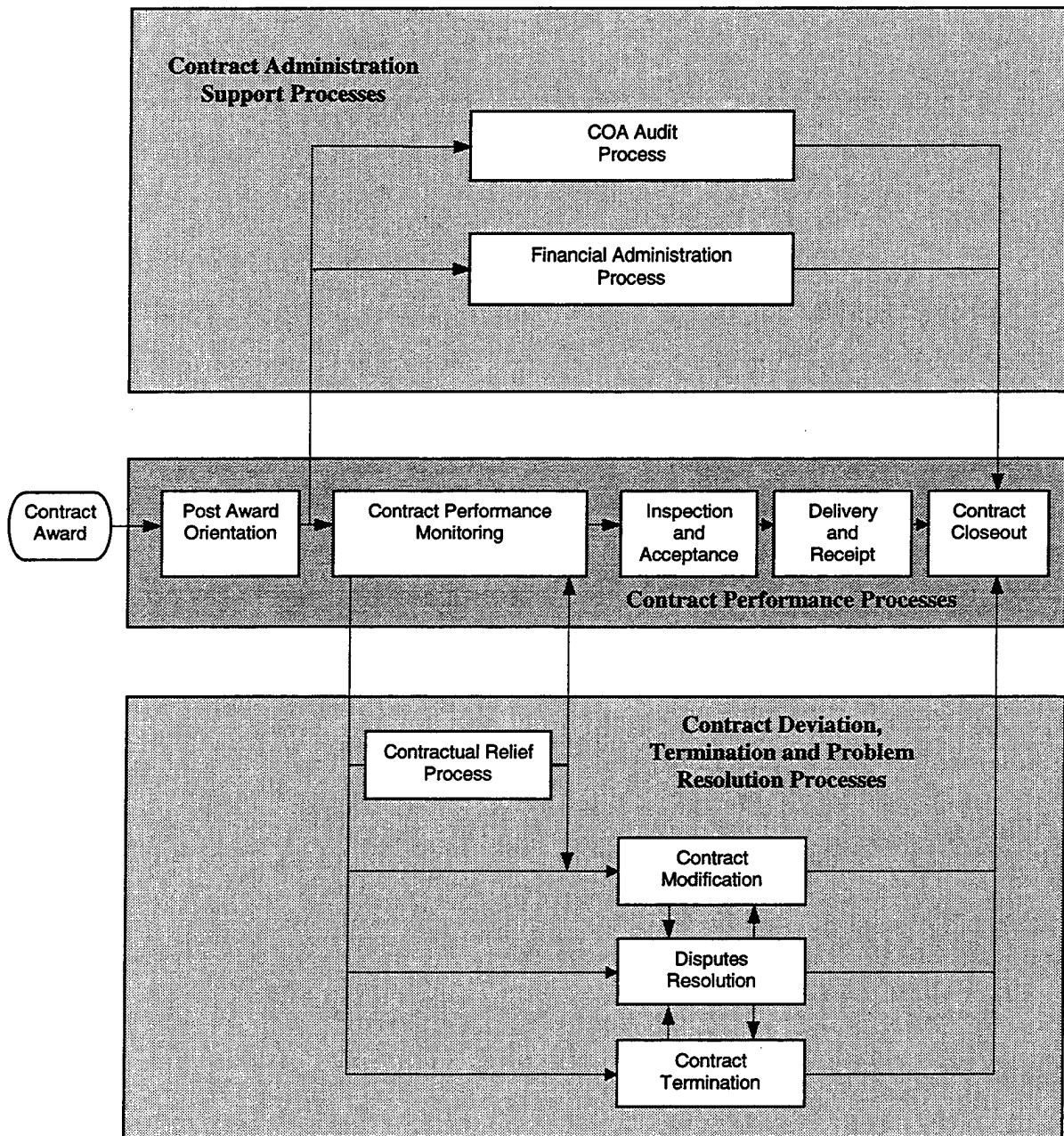
Based on the above attributes, the researcher developed a Model of Contract Administration for the AFP Modernization Program, which is shown in Figure 4. The model is a logical continuation to the present equipment acquisition and contracting process stipulated in DND Circular Nr. 29, and conforms to the provisions and spirit of RA 7898. It follows the basic structure of a regular contract administration system, except that some functions are deleted or modified to improve efficiency, reduce cost and effectively address all the post-award issues identified in Chapter IV.

Similar to the contract administration structure presented in Chapter III, this particular model would also have three major groups of processes, namely Contract Performance, Contract Administration Support, and Contract Deviation, Termination and Problem Resolution.

1. Contract Performance Processes

This group is comprised of core contract administration functions to be performed by the PMT with the contractor. Like the structure presented in Chapter III, it starts immediately after contract award and ends with contract closeout. This group

Figure 4. Model of Contract Administration for the AFP Modernization Program



Source: Developed by the Researcher

ensures the delivery of the services or products according to specified quality, cost and schedule. It includes Post-Award Orientation, Contract Performance Monitoring, Inspection and Acceptance, Delivery and Receipt, and Contract Closeout.

a. Post-Award Orientation Process

Generally, this process is the first step after the award of the contract where the Government redirects its efforts and resources from pre-award to post-award activities. It involves the orientation of the contractor and the delegation of responsibilities to those concerned for satisfying the obligations of the Government under the contract.

In the AFP context, this process would also involve activities that will assure product quality even with less Government oversight of contractor activities. The AFP has no resources and capabilities for active in-plant surveillance of production process. It has to rely on the quality control system of the contractor. Thus, aside from contract administration planning and contract orientation conference, the PMT would also conduct one-time review and evaluation of a contractor's production and management system to ensure that the goods are produced according to the specified quality. This way, the Government is assured early in the process that the contractor's products will pass inspection, and thereby avoid costly rework and possible late delivery. The PMT would also ascertain, through its review of contractor production and management systems, the viability of the subcontracting and the technology transfer arrangements. Other activities to be made in the management reviews are assessment of the contractor's purchasing system, evaluation of contractor maintenance, logistics and safety programs, monitoring of contractor industrial relation, and assessment of the value engineering program.

The PMT would also collect performance bonds and advance payment bonds, when applicable, during this process. The bond would then be deposited with the designated Finance Unit for safekeeping. The PMT also has to review the countertrade arrangement with the Philippine International Trading Corporation (PITC), the contractor, the comptroller and the finance representatives, preferably through the Joint Countertrade Working Group (JCWG). It must ascertain that there are no potential problems and that the countertrade would not hinder timely payment.

b. Contract Performance Monitoring

This process ordinarily involves the monitoring of production status and progress. It ensures that production is progressing smoothly, on schedule and within cost. However, the AFP would have no personnel at the contractor plant to do the actual on-site monitoring, except for an occasional inspection. It would instead rely on certified reports from contractors regarding the progress of production or services, using a standard format. The report covers progress of activities, accumulated and estimated cost, potential or actual delays, discovery of deficiencies in specifications or technical documentation, status and problems in technology transfer, and other relevant issues.

c. Inspection and Acceptance Process

This process involves the inspection and test of products and services to ensure that these conform to the contract specifications. The function would most likely be performed at the contractor's plant. It is the most critical process for ensuring product quality, because it is the only time when the PMT actually examines the products or services. It is the final step for verifying quality, and the last chance for rejecting defective items. This is why the AFP should provide great emphasis on this process.

More so, the process presents the best opportunity to audit and improve the adequacy of the reviews and evaluations made on contractor systems in the earlier processes. Typically, the contractor would perform the product testing for the AFP and would furnish certification that the product performs according to the quality standards of the contractor or the industry. However, a representative from the cognizant PMT must be present to witness the testing and confirm the validity of the test data. The representative would then inspect thoroughly the product and accept it for the AFP.

d. Delivery and Receipt

The end-user receives the contracted item during this process. The process includes transportation management that ensures the safe and prompt shipment of the items according to the terms of the contract. Coordination with Philippine Customs officials and Port authorities are made during this process; ensuring that all fees, duties and taxes required are paid or waived depending on the circumstances. The contractor submits invoices, for approval of the PMT Head or his representative, based on the contract price for the product or work delivered and accepted. The reason for the approval is to protect the interest of the Government by ensuring that payment is commensurate to the work performed. At times, the PMT may not authorize payment in full to reflect adjustments resulting from contract modification, or for some other reasons.

e. Contract Closeout Process

The purpose of this process is to ensure that the contract is administratively completed; wherein both parties have met all contractual obligations. The PMT should start the process immediately after the final delivery. It would have seven days to assess the general status of the contract and another seven days to complete and close all

pending transactions. Normally, the process confirms that the contract is physically complete; the contractor's final invoice, contractor's closing statement, and other reports, forms and clearances are received; the terms and conditions for closeout are satisfied; claims or disputes and outstanding issues are settled; and final payment are made and remaining funds are de-obligated.

2. Contract Administration Support Processes

This group is comprised of the support activities performed by the PMT and other agencies. It is composed of functions performed, when needed, simultaneously with the activities in the Contract Performance Processes to ensure continuous and unhampered performance of the contract. Processes in this group are Audit and Financial Administration.

a. Audit Process

This process primarily involves the audit of contract transactions and contractor invoices by the Commission on Audit (COA) to ensure that these are complete and correct. Most AFP modernization acquisitions are fixed-price type contracts for non-developmental items; as such, they would require minimum audit to ascertain correctness. However, should there be a cost-reimbursement type contract or when circumstances require assurance that all costs reported are allowable, the auditor might further audit the cost accounting system of the contractor. Some activities under this process are audit of contractor budgeting, scheduling and accounting systems, and verification of financial condition of contractors and financial status of contracts.

b. Financial Management Process

This process ensures that funds are released on time to meet obligations and the Government promptly pays the contractor for delivery of products or services. Normally, the designated finance unit makes the payment after the PMT Head approves the invoices. The approval process is relatively straightforward for fixed-price contracts. For cost-reimbursement contracts, however, approval is dependent on a determination of the allowability and allocability of the invoiced costs (direct and indirect costs).

Another aspect of this process is the remittance of payment to overseas contractors directly or through countertrade, including counter-purchase arrangements. The PMT should maintain communication with foreign contractors to assess continuously the effect of countertrade on the timeliness and value of payment. Similarly, the PMT should monitor foreign exchange fluctuations to see to it that the Government or the contractor does not incur losses in currency exchanges.

Also included in this process is the safekeeping and handling of bonds and the collection of liquidated damages for contractor caused delays. The PMT, with the assistance of the auditor and the finance community, may undertake a review of contractor revised estimates for cost at completion, issuance of notice of disallowance, pricing of incentives, review of cost performance reports, and actions to protect the Government financial interest in case of contractor bankruptcy.

3. Contract Deviation, Termination and Problem Resolution Processes

The last group of processes is made up of corrective activities performed by the PMT to bring a sidetracked contract back on its tracks, or steer another to a new path or approach. This group also includes processes that, if called for, could end a contract

before completion of contract performance, primarily to protect the interest of the Government. Similar to the structure in Chapter III, the group involves Contractual Relief Process, Contract Modification, Dispute Resolution, and Contract Termination Process.

a. Contractual Relief Process

The contractual relief process involves functions performed during the performance period to correct performance problems, like delays, or those leading to "stop work" situations. Ordinarily, delays are resolved through extensions if the delay is excusable, or through equitable adjustments if the Government is at fault. "Stop work" notices are temporary stoppages of contract performance that end automatically after the mandated grace period unless extended through supplemental agreements or work permanently stopped by contract termination. Other remedies within this process are the assessment of liquidated damages, rejection of non-conforming work, and exercise of applicable warranty or guarantee.

b. Contract Modification Process

The contract modification process involves activities that lead to written changes in the terms and/or conditions of the contract provided these are not cardinal changes. Modification is initiated by a change proposal from either party. If accepted, changes leads to equitable adjustments in the contract price, delivery schedule or other elements of the contract. Any change should only be effected through bilateral contract modification using a supplemental agreement. Since modernization contracts are negotiated, approved and signed at GHQ and DND, all supplementary agreements, although initiated at PMT level, should also be negotiated and approved at GHQ/DND

level. Some activities made during this process are the evaluation of contractor engineering change proposals, requests for deviation, negotiation on contract price adjustments, and review of contractor revised estimates of cost at completion, work plans, and others.

c. Disputes Resolution Process

The contracting parties resort to this process when there is material disagreement between the Government and the contractor. The resolution process begins with the submission of a Claim by the contractor. The Project Management Officer then issues a Counter-position, which is forwarded to the Major Service MPMO, together with the contractor's Claim, for negotiation of amicable settlement. If no agreement is reached, the Director of the Major Service shall issue a Final Decision, which the contractor could then appeal to the DND Contracts Appeals Board or the cognizant Regional Trial Court for litigation. From there, the case, depending on its merits could be elevated to the Court of Appeals. Then as a final step, the case could be appealed at the Supreme Court of the Philippines if the merits of the case warrant it. Should the contractor elect, or if the contract provisions specify, the contract dispute may be settled through arbitration or other Alternate Disputes Resolution (ADR) before litigation.

d. Termination Process

The Philippines has not practice the principle of contract "termination for convenience." However, based on the analysis presented in Chapter IV, the AFP and the Government should have the right to cancel any contract when the Government's requirement has substantially changed or been cancelled. When the Government requirement changes, the contract has to be terminated partially or wholly to avoid

useless expenditure of public funds. Thus, in these cases, the AFP through the PMT should be allowed to issue a unilateral notice terminating the contract for the convenience of the Government. A supplemental agreement would then be negotiated with the contractor reflecting the resulting change in price, disposition of property, and other matters affected by the termination.

On the other hand, when the contractor is failing to perform in accordance with the terms and condition of the contract, the PMT may exercise the right to terminate the work, in whole or in part, for contractor default. When sufficient evidence exists to suspect that the delivery or other performance requirements are not likely to be met, the PMT may issue a 90-day "cure notice" to warn the contractor to perform better and deliver requirements within schedule. If the contractor fails to heed the "cure notice," then the termination for default may proceed. On the other hand, when the delivery due date elapsed before the contractor could comply, the PMT may either issue a "show cause" letter to the contractor to allow him to explain his failure, or immediately initiate default termination. Once the contract is terminated, the AFP may secure a new contract from another source.

D. SUMMARY

This chapter discussed the characteristics a Model of Contract Administration AFP acquisition environment should possess. This model must facilitate the effective execution of the contract using minimum manpower and resources. This chapter also enumerated several essential elements of the Model, which were categorized into Statutes and Regulations, Key Organizations, and Contract Administration Procedures. These elements make up the different functional parts of the model. Finally, this chapter

showed and described the Contract Administration Model developed by this study for the AFP Modernization Program. The model resembles the general Contract Administration Structure, streamlined to reduce non-applicable functions in order to minimize implementation cost; it also incorporates some unique features relevant to the AFP of acquisition environment.

In the following chapter, the researcher presents conclusions and recommendations of this study.

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VI. CONCLUSIONS AND RECOMMENDATIONS

A. INTRODUCTION

This chapter presents the findings and recommendations of the study. So far, this research provides valuable information and insight on the AFP Modernization Program and challenges associated with program implementation. Chapter II examined the relevant acquisition laws and regulations, and the inadequacy of the AFP equipment acquisition and contracting process. Chapter III reviewed the general contract administration structure and processes. In Chapter IV, the research examined the post-award experiences, perceptions and concerns of the AFP modernization and acquisition experts and officials, which the study concluded are the current post-award issues associated with the AFP Modernization Program. In Chapter V, the study developed a proposed Model of Contract Administration that would best address the post-award issues associated with the AFP modernization and acquisition process. Therefore, consolidating all the knowledge gained from the research, the study now presents its conclusions.

B. CONCLUSIONS

Based on the data and information presented, analyzed and interpreted in the preceding chapters, the following are the conclusions of the study:

1. The model of contract administration most effective for the AFP Modernization Program is a structure:

- a. Comprised of eleven major processes, namely: Post-award orientation, Contract Performance Monitoring, Inspection and Acceptance, Delivery, Audit, Financial

Administration, Contractual Relief, Contract Modification, Disputes Resolution, Contract Termination, and Contract Closeout;

b. Possessing the following characteristics, namely: reliance on contractor insight instead of Government oversight, requires limited resources, allows guaranteed product testing by contractors, conducive to field performance feedback and warranty application, effective for technology transfer and countertrade arrangement, and effective for administrative resolution of contract disputes;

c. Regulated by DND Implementing Guidelines based on the authority of the AFP Modernization Act, RA 7898; and

d. Implemented by the Modernization Program Management Office of each Major Service, through designated Project Management Teams (PMTs), with the support of the AFP Finance and Accounting units, the DND Contract Appeals Board, and the Commission on Audit.

2. There are twelve post-award issues associated with the AFP Modernization Program. These issues are manifested in the AFP major system procurement contracts and reflected in the professional experiences and perceptions of experts and practitioners in the AFP modernization and acquisition system.

3. The present Contract Administration System in the AFP is too fragmented and inadequate to address the post-award issues associated with the AFP Modernization Program. The Philippine military and defense establishment actually does not have a comprehensive system of contract administration. It has to rely on three Government regulations, namely: DND Circular 29, Major Services Project Management SOPs, and COA Government Accounting and Auditing Procedure, to be able to implement

contracts. However, none of them even in combination with one another totally covers the different aspects of contract administration peculiar to major system acquisitions under the AFP Modernization Program.

4. The AFP presently has no internal system to resolve contract disputes before court litigation or third party arbitration.

5. The AFP, in general, has limited resources for full oversight of contract performance. It lacks personnel, facilities, funding and skills to conduct on-site production surveillance, product quality testing and audit of contractor production cost.

6. The PMTs are not formed or sufficiently involved early enough in the contract formation process. This shortsightedness places the PMTs, and the AFP as a whole, at a disadvantage when dealing with the better-exposed and more informed contractor representatives in the execution of AFP contracts.

C. RECOMMENDATIONS

In view of the above, this study recommends the following:

1. The adoption by the AFP of the Model of Contract Administration introduced in Chapter V. The Model results from analysis of inputs provided by AFP leaders and officers, who are knowledgeable and experienced in AFP acquisition, and data extracted from the study of AFP systems acquisition contracts. It is, therefore, the most suited structure for systems acquisition under the AFP Modernization Program.

2. The Department of National Defense (DND) should revise the DND Circular No. 29 to incorporate important provisions for contract administration. The DND has enough authority under the AFP Modernization Act, RA 7898, to revise Circular No. 29. Section 14 of RA 7898 requires the DND and the AFP to strengthen their systems and

procedures for equipment and major systems acquisition pursuant to the AFP Modernization Program. Circular No. 29 is the Implementing Regulation promulgated by DND pursuant to Section 14, but this research revealed that the Circular is inadequate and lacks the necessary provisions to implement and administer contracts for system acquisitions. Thus, based on the same authority provided by RA 7898, DND could further strengthen Circular No. 29 by including comprehensive procedures for the effective and holistic administration of AFP contracts.

3. The establishment of DND Contract Appeals Board and the promulgation of an appropriate procedure for the resolution of claims and contract disputes within the DND.

4. The AFP should continue to rely on contractor insight to ensure the quality of products or services. It must develop a cost-effective process to minimize the use of AFP personnel and resources for contractor oversight.

5. The revision of DND Circular No. 29 to require the establishment and operation of the Program Management Teams throughout the life cycle of their respective projects. The PMT should play an active role in every stage of the acquisition process. It must be involved from the determination of operational requirements, up to the termination of the project. The PMT must be the primary organization involved in the formulation and administration of contracts for system acquisition.

6. In relation to the third recommendation, AFP SOP No. 2 should be revised to include the Project Management Officer or the PMT's Contract Specialist as a member of the cognizant Bids, Awards and Negotiations Committee (BANC). This way, the PMT will be continuously involved with the acquisition process including contract formation.

D. ANSWERS TO RESEARCH QUESTIONS

1. Primary Research Question

What are the essential post-award issues associated with the Armed Forces of the Philippines Modernization Program, and what would be the appropriate model of Contract Administration to address these issues?

In Chapter IV, the study identified twelve post-award issues associated with the Armed Forces of the Philippines Modernization Program, and these are:

- a. Quality of Product and Services
- b. Timeliness of Delivery
- c. Promptness of Payment
- d. Efficient Financial Administration
- e. Appropriate Contract Modification and Equitable Adjustment of Price
- f. Expedient Resolution of Disputes
- g. Just Termination of Contracts
- h. Satisfactory Completion of the Contract
- i. Audit of Contract Transactions
- j. Documentation of Post-award Activities
- k. Early Establishment of Project Management Teams
- l. Control of the Cost of the Acquisition Process

Chapter V presented the appropriate Model of Contract Administration to address the above issues. The Model consists of 11 contract administration processes, which are divided into three major groups, namely Contract Performance Processes, Contract Administration Support Processes, and Contract Problem Resolution and Termination Processes. The Model has several elements categorized into statutes and regulations, key organizations, and standardized procedures, and characterized by ten attributes which adapts it to the AFP acquisition and contracting environment.

2. First Subsidiary Question

What is the present structure of contract administration in the AFP?

As discussed in Chapter II. The AFP does not have a single, comprehensive system for contract administration. It has to adhere to several regulations promulgated by different Government agencies in order to administer its contracts. In its Modernization Program, the AFP has to use three sets of rules and regulations to implement its major systems contracts. These regulations are DND Circular 29, Major Service Circular on Project Management and COA Government Accounting and Auditing Procedure. These regulations, even in combination, do not fully cover the whole spectrum of contract administration. Contract management areas, like Contractor Management System Review, Contract Closeout and Contract Disputes Resolution, are not adequately addressed in these regulations.

3. Second Subsidiary Question

What are the critical post-award problems that routinely arise in contract administration?

Below are critical post-award problems, identified in this study, that routinely arise during contract performance:

- a. Non-Compliance to Contract Specification
- b. Disagreement on Contract Modifications and Equitable Adjustments
- c. Disagreement in the Result of Inspection and Warranty of Deliverables
- d. Settlement of Claims
- e. Contractor Financial Difficulty and Bankruptcy
- f. Issues with Government-Furnished Property
- g. Subcontractors and Privity of Contract
- h. Importance of Contractor Production for National Defense

4. Third Subsidiary Question

How are these problems typically resolved?

The critical post-award problems presented above are typically resolved through proper application of contract administration procedures. Contract administration evolved, by operation of law and by legislation, from practices and actions of contracting parties to resolve contract performance problems. Although, the primary purpose of contract administration is to protect the interests of the Government during contract performance, its eventual outcome turns out to be also beneficial to the contractor.

5. Fourth Subsidiary Question

What are the essential characteristics and elements of a contract administration model for the AFP Modernization Program?

The essential elements of a contract administration model for the AFP Modernization Program, identified and discussed in Chapter V, are categorized into statutes and regulations, key organizations, and standardized procedures. The characteristics of the model are the following:

- a. The model is structured to allow more reliance on contractor insight than Government oversight for the timely delivery of right quality products and services to the AFP.
- b. The model facilitates review and audit of contractor production, accounting and management systems early in the contract administration process to ensure satisfactory contractor performance throughout the execution of the contract.
- c. The model permits product testing by the contractor provided the activity is witnessed and the results verified by the AFP.

d. The model ensures the effective transfer of essential technology to the Philippines and the proper implementation of the countertrade arrangements required for all contracts with the Philippine Government.

e. The model is structured to promote prompt payment to contractors, facilitate control of contract cost, expedite collection of bonds and liquidated damages, and ensures quick and proper contract closeout.

f. The model promotes interaction between the end-user and the PMT to enhance feedback from the field regarding the operational performance of the product, and facilitate prompt application of warranty when needed.

g. The model is structured to encourage administrative resolution of contract disputes within the normal 60-day grace period provided in most AFP contracts before resorting to ADR arranged by the International Chamber of Commerce.

h. The model is structured to encourage the establishment of PMTs before the determination of the operational requirements, and maintain the PMT throughout the life cycle of the project.

i. The model functions with the least amount of manning and resources.

j. The model allows incorporation of innovative approaches to contract administration.

6. Fifth Subsidiary Question

What changes in Philippine laws and/or regulations should be considered to

incorporate the critical functions and processes of contract administration into the AFP Acquisition Process?

No change in Philippine laws is needed to incorporate the critical functions and processes of the Contract Administration Model into the AFP Acquisition Process. The AFP Modernization Act, RA 7898, provides adequate direction and authority for the execution of AFP modernization contracts. It is only the DND Circular 29 that needs to be amended in order to fully utilize the authority provided by the statute for the AFP Modernization Program. The DND must update Circular 29 to incorporate the Model of Contract Administration developed by this study in order to effectively and efficiently implement all acquisition contracts under the AFP Modernization Program.

E. SUGGESTIONS FOR FURTHER RESEARCH

1. Validation of the Model presented in this study using actual data gathered after the implementation of the AFP Modernization Program. The study would examine the applicability and usefulness of the model in the AFP acquisition process.

2. The examination and the validation of the different segments of the Model presented in this study. The thesis covered a very broad area. Contract Administration is a system made up of several processes and not all these processes can be extensively studied in a single thesis. Thus, it would be worthwhile to come with a study for each process to validate its individual relevance or importance to the AFP contracting environment and develop a more detailed model for each in the process.

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APPENDIX A. INTERVIEW QUESTIONNAIRE

Following are the interview questions answered by Brigadier General Lysias C. Cabusao AFP, Director of the AFP Modernization Program Management Office; Colonel Froilan M. Maglaya PA(GSC), Assistant Chief of Staff for Plans of the Philippine Army; and Captain Emilio C. Marayag PN(GSC), Director, Naval Modernization Office through mail.

I. Implementation of Contracts

1. DND Circular 29 dated 19 May 1996, "Implementing Guidelines to RA 7898" delegated the implementation of AFP modernization contracts to the Major Services. In the case of the Philippine AFP/Army/Navy, what unit or who in particular is tasked to implement such contracts?

Answer:

2. How will the AFP/Army/Navy implement the contract through this/these unit(s) or individual(s)? Is the current set of acquisition laws and regulations adequate for proper implementation of contracts? Please explain.

Answer:

3. Some countries have an extensive Contract Administration (CA) system that allows complete oversight of the execution of contracts by contractors. Does the AFP/Army/Navy have something similar in place or being developed?

Answer:

4. Which do you think is more prudent for PN, a CA system that allows complete oversight, or a simple process that relies completely on the contractor for the performance of the contract provided it conforms to the provisions of the contract, or a process somewhere in between? Please explain.

Answer:

II. Contract Administration System

Contract Administration covers all post-award activities essential for the fair and mutually beneficial execution of the contract. It is comprised of several processes, which will be discussed individually in the succeeding questions. These are quality assurance; inspection, acceptance and delivery; payment, accounting and audit; government furnished property and supply; contract modification; dispute resolution; contract termination; and contract close out.

1. Production surveillance and quality assurance – A process that ensures that the contractor produces the right product according to specifications stipulated in the contract.

a. Does the AFP/Army/Navy consider this process relevant for the proper performance of modernization contracts?

b. If relevant, how would the AFP/Army/Navy implement the process? What unit or who in the Philippine AFP/Army/Navy will be tasked to do this process?

c. Are there sufficient rules and regulations in the Army/Navy or the AFP to govern this process besides the terms and conditions written in each contract? If no, do you think the AFP/Army/Navy needs to formulate a policy for Production Surveillance and Quality Assurance? Please explain.

Answer:

2. Inspection, acceptance and delivery

a. Does the AFP/Army/Navy consider this process relevant for the proper performance of modernization contracts?

b. If relevant, how would the AFP/Army/Navy implement the process? What unit or who in the Philippine AFP/Army/Navy will be tasked to do this process?

c. Are there sufficient rules and regulations in the Army/Navy or the AFP to govern this process besides the terms and conditions written in each contract? If no, do you think the AFP/Army/Navy needs to formulate a policy for Inspection, Acceptance and Delivery? Please explain.

Answer:

3. Payment, accounting and audit – A process that ensures that the contractor charges the correct cost and sets the right price. In addition, it ensures that the government pays the contractor promptly.

a. Does the AFP/Army/Navy consider this process relevant for the proper performance of modernization contracts?

b. If relevant, how would the AFP/Army/Navy implement the process? What unit or who in the Philippine AFP/Army/Navy will be tasked to do this process?

c. Does the Government have the mandate and the resources to audit contractors?

d. Are there sufficient rules and regulations in the Army/Navy or the AFP to govern this process besides the terms and conditions written in each contract? If no, do you think the AFP/Army/Navy needs to formulate a policy for Payment, Accounting and Audit? Please explain.

Answer:

4. Government Furnished Property and Supplies – A process that governs the use of government properties and supplies in the contractor's production process. It also covers the issue of ownership over sub-systems produced/acquired by the contractor prior integration to the final product.

a. Does the AFP/Army/Navy consider this process relevant for the proper performance of modernization contracts?

b. If relevant, how would the AFP/Army/Navy implement the process? What unit or who in the Philippine AFP/Army/Navy will be tasked to do this process?

c. Who will have ownership of sub-systems (engines, radars, communications and electronics equipment, weapons, etc) possessed by contractors prior to completion and delivery of the contracted product?

d. Are there sufficient rules and regulations in the Army/Navy or the AFP to govern this process besides the terms and conditions written in each contract? If no, do you think the AFP/Army/Navy needs to formulate a policy for Government Furnished Property?

Answer:

5. Contract Modification – A process that incorporates changes including equitable price adjustment to contracts caused by change orders, deviations, delays, novations, etc. It includes procedures to determine accurately the changes made and the equitable costs of such changes to the contractor.

a. Does the AFP/Army/Navy consider this process relevant for the proper performance of modernization contracts?

b. If relevant, how would the AFP/Army/Navy implement the process? What unit or who in the Philippine AFP/Army/Navy will be tasked to do this process?

c. Are there sufficient rules and regulations in the Army/Navy or the AFP to govern this process besides the terms and conditions written in each contract? If no, do you think the AFP/Army/Navy needs to formulate a policy for Contract Modification? Please explain.

Answer:

6. Disputes resolution – A process that provides an administrative forum and procedure to hear contractors' claims and appeals regarding the contract or decisions of government officials before a third party Alternate Disputes Resolution (ADR) or Court Litigation.

a. Does the AFP/Army/Navy consider this process relevant for the proper performance of modernization contracts?

b. If relevant, how would the AFP/Army/Navy implement the process? What unit or who in the Philippine AFP/Army/Navy will be tasked to do this process?

c. Are there sufficient rules and regulations in the Army/Navy or the AFP to govern this process besides the terms and conditions written in each contract? If no, do you think the AFP/Army/Navy needs to formulate a policy for Disputes Resolution? Please explain.

Answer:

7. Contract termination – A process carried out by the government to cancel a contract because of breach by the contractor or other causes.

a. Does the AFP/Army/Navy consider this process relevant for the proper performance of modernization contracts?

b. If relevant, how would the AFP/Army/Navy implement the process? What unit or who in the Philippine AFP/Army/Navy will be tasked to do this process?

c. Are there sufficient rules and regulations in the AFP/Army/Navy or the AFP to govern this process besides the terms and conditions written in each contract? If no, do you think the AFP/Army/Navy needs to formulate a policy for Contract Termination? Please explain.

d. Is there a necessity for the Government to adopt the principle of “Termination for Convenience of the Government” for projects overtaken by events?

Answer:

8. Contract closeout – A process that ensures that all provisions of the contract were properly and fully carried-out, that all items were delivered and correctly invoiced, full payment made and there are no pending disputes, modifications or termination initiatives.

a. Does the AFP/Army/Navy consider this process relevant for the proper performance of modernization contracts?

b. If relevant, how would the AFP/Army/Navy implement the process? What unit or who in the Philippine AFP/Army/Navy will be tasked to do this process?

c. Are there sufficient rules and regulations in the Army/Navy or the AFP to govern this process besides the terms and conditions written in each contract? If no, do you think the AFP/Army/Navy needs to formulate a policy for Contract Closeout? Please explain.

Answer:

III. Countertrade

1. Does the AFP/Army/Navy have control or oversight over the Philippine International Trade Corporation (PITC) in the implementation of countertrade (CT) agreement?

Answer:

2. Is PITC compensated for its CT services? If yes, how is it made? Will it add to the procurement cost?

Answer:

3. Can the AFP/Army/Navy assure its contractors that they will not be short-changed by the CT arrangement?

Answer:

4. Do you think countertrade will be a problem for the AFP/Army/Navy in implementing its contracts? Please explain.

Answer:

IV. Recent Experience

1. The AFP recently concluded contracts for the supply of Simba Armored Personnel Carriers and S-211 Aircraft, and for the transfer of three Peacock Class Patrol Vessels to the Philippine Navy/Army/Air Force. Did the AFP/Army/Navy experience difficulties/problems in the implementation of the contract? If it did, what are these and please explain the circumstances.

Answer:

2. Do you think these problems will be prevented/mitigated if the Army/Navy or the AFP have a definite Contract Administration process and system in place? Please explain answer.

Answer:

V. Miscellaneous

1. Do you think it is necessary for the AFP/Army/Navy to train and assign contract specialists to units/individuals tasked to implement AFP modernization contracts? Please explain.

Answer:

2. DND-GHQ,AFP allows the use of cost reimbursement contracts for the modernization program. This type of contract requires greater oversight of contractors than a fixed-price contract. Do you think the AFP/Army/Navy or the Defense Establishment presently has the system and resources to exercise the necessary oversight particularly cost accounting and audit of cost reimbursement contracts? Please explain/elaborate answer.

Answer:

3. Regarding import tariffs, does the AFP/Army/Navy have a working arrangement with the Bureau of Customs to facilitate the importation of weapon systems, production materials, spare parts and others?

Answer:

4. Congress will review a contract at about the same time the Secretary of National Defense directs the concerned Major Service to implement it. In case Congress finds something it does not like about the contract, could it stop implementation of the project or order changes into the contract? If it could, do you think the AFP/Army/Navy

needs to have a special set of procedures to accommodate Congress wishes without gravely affecting the contractual position of the AFP?

Answer:

5. As a final statement, what is your general opinion of the AFP acquisition process and what can you conclude about the AFP/Army/Navy's present disposition for contract implementation as required by DND Circular 29?

Answer:

APPENDIX B. SURVEY QUESTIONNAIRE

From: LCDR CAESAR C TACCAD PN

To: Survey Respondent

Subj: Survey

Encl: Survey Questionnaire

1. Attached is a survey I am administering for my thesis at the Naval Postgraduate School. My research is about implementation of acquisition contracts for the AFP Modernization Program. The purpose of the study is to develop a model of Contract Administration for the AFP Modernization Program.

2. In this connection, request you answer each question truthfully and completely.

3. This is just a survey. There are no right or wrong answers; the only correct answers are those that truthfully reflect your opinion about the questions.

4. The answers will not be attributed to you. Your name is not required. What are needed are your thoughts and ideas about the subject.

Survey Questions

Part I – Profile

Rank _____ Branch of Service _____ Station _____
Position _____ Unit/Office _____

1. Has your unit/office performed tasks directly/indirectly related to the AFP Modernization? []Yes []No

2. If yes, briefly describe it. _____

3. Have you performed tasks/duties directly/indirectly related to the AFP Modernization? []Yes []No

4. If yes, briefly describe it. _____

5. When the AFP Modernization Program gets into full gear, do you expect your unit/office or your Position to be involved directly/indirectly with the implementation of acquisition contracts?

Unit/Office [] Yes [] No

Position [] Yes [] No

6. If yes, briefly, in what way? _____

Part II – Implementation of AFP Modernization Contracts

DND Circular 29 delegated the implementation of modernization contracts to the Major Services. Presumably, the task will be managed by the Modernization Office of each Service and performed by the designated Project Officer for each contract. The DND circular and the accompanying GHQ, AFP SOP 2 appropriately defined the process for contracting or entering into contracts with proponents. However, both directives did not specify, except for the required reports, the procedures on how the Major Services would implement the contracts. Presumably, the process will be inferred from the provisions of the contract itself. In this case, the “terms and conditions” of a particular contract, the existing AFP Procurement Regulation and the current Government Accounting and Auditing Procedure are the only guidelines available to the Major Services in governing the implementation of contracts. The purpose of this survey is to establish if the implementors are comfortable with the setup and confident that they could accomplish their tasks despite very little guidance, standards and direction.

1. Based on your professional observation, is the AFP ready to implement the Modernization Program? [] Yes [] No

Why or why not? _____

2. Are the Major Services prepared and ready to implement modernization contracts? [] Yes [] No

Why or why not? _____

3. Are the existing Government rules and regulations adequate for the proper and smooth implementation of AFP modernization contracts? [] Yes [] No

Why or why not? _____

4. The process of implementing contracts is called Contract Administration (CA). CA has several sub-processes. Please rate by encircling the number that corresponds to how much relevant or needed the following sub-processes for the implementation of AFP modernization contracts.

	Very Relevant					Very Irrelevant	Don't Know Relevance	Don't Know Process
a. Product Surveillance and Quality Assurance	5	4	3	2	1		0	X
b. Inspection & Acceptance	5	4	3	2	1		0	X
c. Traffic and Transportation Management	5	4	3	2	1		0	X
d. Audit & Contractor Management Review	5	4	3	2	1		0	X
e. Financial Management	5	4	3	2	1		0	X
f. Government Furnished Property Management	5	4	3	2	1		0	X
g. Contract Modification	5	4	3	2	1		0	X
h. Contract Termination Procedure	5	4	3	2	1		0	X
i. Disputes Resolution	5	4	3	2	1		0	X
j. Contract Closeout	5	4	3	2	1		0	X

5. Among these sub-processes, which do you think will be tasked directly/indirectly to your unit/office to support the implementation of AFP modernization contracts? _____

6. Which of these sub-processes do you think your Position will perform for the AFP Modernization? _____

7. Are you confident that you will be able to perform properly the sub-process(es) that may be assigned to your Position for the AFP Modernization? []Yes []No
Why or why not? _____

Part III – Contract Specialist

A contract specialist is a person assigned to perform contracting duties. He/she is trained and knowledgeable in both the pre-award and post-award contracting processes. Pre-award includes the activities made to formulate or develop a contract. While, post-award includes those done to perform or execute the contract.

1. Do you think this position is necessary for the AFP Modernization Program?

[]Yes

[]No

Why or why not? _____

2. If yes, from what functional staff or unit should this person be tapped?

(ex. Personnel, Intelligence, Operations, Logistics, etc) _____

3. If no, who do you think should perform the post-award or contract administration function for the AFP Modernization? _____

Thank you very much for your cooperation.

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